No. 86-1038

In the Supreme Court of the United States

October Term 1986

Supreme Court, U.S.
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JOSEPH F. SPANIOL, JR.
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JAMES W. BAKER, et al.,

Appellants,

v.

CITY OF SANTA MONICA, et al.,

Appellees.

JOHN J. STEIN, et al.,

Appellants,

v.

CITY OF SANTA MONICA,

Appellee.

ON APPEAL FROM THE COURT OF APPEAL, SECOND DISTRICT OF THE STATE OF CALIFORNIA

JURISDICTIONAL STATEMENT

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QUESTIONS PRESENTED

1. How does the judiciary ensure that the returns allowed by administrative rate setting agencies are not unconstitutionally confiscatory?

2. Are returns allowed to be received by landlords under Regulations 4040 and 4100 of the Santa Monica Rent Control Board unconstitutionally confiscatory?

3. Do the distinctions made between owners under Regulation 4040 deny the owners their right of equal protection?

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JURISDICTIONAL STATEMENT

OPINIONS BELOW

The Opinion of the California Court of Appeal, Second Appellate District (Appendix A, *infra*) reversing the judgment of the Superior Court is reported at 181 Cal. App. 3d 972, 226 Cal. Rptr. 755 (1986). A rehearing by the Court of Appeal was denied on June 26, 1986. On September 19, 1986, the California Supreme Court denied review of the decision of the Court of Appeal, with Justices Mosk, Lucas, and Panelli of the opinion that the review should have been granted. (Appendix B, *infra*). On October 8, 1986, the Court of Appeal issued the remittitur and its opinion became final on that date.

The trial before the Superior Court was bifurcated into four separate trials with a decision and findings (or a Statement of Decision) issued with respect to each of the first three bifurcated phases. (Appendices D through J, *infra*). A judgment was issued on July 14, 1983. (Appendix K, *infra*). These decisions and judgment are unreported.

JURISDICTION

The decision of the Court of Appeal became final on October 8, 1986. A notice of appeal to the Court of Appeal was filed on November 14, 1986. (Appendix C, *infra*). The jurisdiction of this Court is invoked under 28 U.S.C. 1257(2).

CONSTITUTIONAL PROVISIONS INVOLVED

The Fifth Amendment to the United States Constitution provides in pertinent part:

> . . . nor shall private property be taken for public use without just compensation.

The Fourteenth Amendment to the United States Constitution provides in pertinent part:

> No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty or property without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

STATUTES AND ORDINANCES INVOLVED

Santa Monica City Charter, Article XVIII (as originally adopted on April 10, 1979 (Appendix L, *infra*) and as revised on November 6, 1984 (Appendix M, *infra*)). Santa Monica City Ordinance 1255 (Appendix N, *infra*). Santa Monica Rent Control Board Regulations 4040 et seq. (Appendix O, *infra*) and Santa Monica Rent Control Board Regulations 4100 et seq. (Appendix P, *infra*).

STATEMENT OF FACTS

The City of Santa Monica (the "City") is a California charter city, located adjacent to the Pacific Ocean and surrounded on the remaining three sides by the City of Los Angeles. At all times relevant to this lawsuit, tenants constituted between 75 and 80 percent of the registered voters of the City.

On April 10, 1979, the voters of the City enacted by initiative an amendment adding Article XVIII to the City Charter, which provided for residential rent controls, adopted prohibitions against the removal of any rental housing, and established an elective, five-member Rent Control Board (the "Board") to administer the Charter Amendment.

A. Regulation 4040.

After its election, the Board adopted a regulation prescribing the method by which rent levels would be calculated. This regulation (denominated "Regulation 4040," attached hereto as Appendix O) created a presumption that whatever return was being realized by the owner of the property on April 10, 1978[1] constituted a fair return. (Regulation 4040(e)(1)). Through general and individual rent increases, Regulation 4040 was designed to preserve this 1978 return indefinitely, in nominal dollars without compensation for any erosion of the income due to inflation.[2] In the event an owner rebutted the presumption that his or her 1978 return was fair, the owner was then entitled to a return on the actual

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[1]Under the Charter Amendment, all rents were rolled back to their level one year prior to the adoption of the law. Such rollbacks have been held to be justified on the theory that the "rollback date" reflects the last date in which the rental marketplace was in equilibrium. *Birkenfeld v. City of Berkeley,* 17 Cal. 3d 129, 166, 130 Cal. Rptr. 465, 550 P. 2d 1001 (1976).

[2]The trial court found that the average rate of return for Santa Monica owners from rental income alone was between one and two percent on the pre-rent control, 1978 value of the owners' equity. Appendix E-5. See n.7, *infra.*

cash (known as "historic cash investment") that had been invested in the property by whoever owned the property on April 10, 1979. (Regulation 4040(e)(3)). "Historic cash investment" was defined to mean the amount of the 1979 owner's original downpayment plus subsequent payments on principal and for capital improvements, if any, all in historic dollars without adjustment for inflation. (Regulation 4040(a)(1)). The rate of return allowed on the historic cash investment was the average rate for the preceding four years that had been paid on triple A rated corporate bonds. (Regulation 4040(e)(3)). This return was then reduced by certain presumed tax benefits. (Regulation 4040(c)). Increased indebtedness or interest obligations incurred after April 10, 1979 due to acquisition, refinancing, or changes in variable rate mortgages were not grounds for rent increases and were irrelevant to any return computations under Regulation 4040. (Regulation 4040(d))[3].

In addition to maintaining the owners' average return at between one and two percent on their pre-rent control, 1978 equity, the application of Regulation 4040 also created a discrepancy in treatment between identical properties based on the circumstances under which the person who had owned the property on April 10, 1979 had originally acquired and financed it. Owners who had acquired their properties years ago prior to inflation and appreciation were given meager returns[4] compared to owners who had purchased their properties in more recent years with depreciated dollars.

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[3]Numerous Board decisions were in evidence before the trial court. For convenience, these decisions are identified herein by their Rent Control Board Rent Adjustment number ("RA"). In RA 114, the Board refused a rent increase to an owner who had purchased his property four months after the adoption of the Rent Control law, notwithstanding the Board's finding that the owner was sustaining an annual negative cash flow of $33,611.00. In RA 267 the Board similarly refused relief for an owner who acquired the property in January, 1980 and had a $6,975 annual negative cash flow.

[4]In RA 362 the petitioner purchased the land and moved an

Owners who had acquired their properties by gift or bequest were deemed to have no investment at all in their properties, other than any inheritance tax paid.[5] Owners who had refinanced their properties prior to 1979 and had thereby taken out their equity were also deemed to have no investment at all upon which a return would be granted.

B. Regulation 4100.

Regulation 4100 (Appendix P) was adopted by the Board after the trial court struck down Regulation 4040. In Regulation 4100 the rent levels were calculated to permit each owner to maintain a net operating income equal to the net operating income (*i.e.*, net income without deduction for debt service) that was being realized from the property on April 10, 1978, increased to the present by 40 percent of the increase in the consumer price index during the same timeframe.

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existing house to the site in 1961 at a total cost of $24,600. The 1978 equity was approximately $100,000. The Board refused a rent increase on the grounds that the owner's annual profit of $1,992 provided him an 8 percent return on his "investment."

In RA 276, the owner had acquired title to his property in 1968 and presented evidence that the pre-rent control value of the property was $375,000. The Board reached back to the 1968 value for computing the owner's return—a return of 2.12 percent on the pre-rent control equity.

In its decision, the trial court found that a hypothetical case testified to by a Board expert permitted an annual cash flow of $293.45 to an owner of a property with a pre-rent control equity of $100,000.00. (Appendix D-19).

[5]In RA 230, the Board found held that the total "investment" upon which the owner who had inherited the property could claim a return was $1,320—the amount of his unamortized balance of capital improvements. This interpretation was subsequently modified to permit such owners to realize a return calculated on the gift or inheritance tax that had been paid on the property. In RA 384 the owner's "investment" upon which his return was computed was determined to be $14,390—the amount of inheritance tax that was paid on property that had been appraised at $250,000.

C. Decisions of the Trial Court.

Plaintiffs brought this action challenging all elements of the Rent Control Charter Amendment and the regulations adopted thereunder by the Board. The trial court bifurcated the action into two parts, the first relating to the returns allowed under the law and the regulations and the second relating primarily to the prohibitions against removal of rental units.

In Phase I of the trial, the trial court heard expert economic testimony and received into evidence a detailed survey and regression analysis of the entire rental housing market in the City, computer-assisted analysis of the Board's registration forms containing the rental information of every regulated rental unit in the City, and numerous actual decisions by the Board implementing Regulation 4040. In its ruling, the trial court upheld generally the constitutionality of the Rent Control Charter Amendment[6], but found Regulation 4040 unconstitutional on the grounds (a) that the returns permitted by the regulations were, or necessarily would become, confiscatory in a substantial number of cases[7] and (b) that the methodology of determining the rent levels violated the owners' equal protection rights.[8]

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[6]Memorandum of Intended Decision, Appendix D, and Revised Findings of Fact and Conclusions of Law, Appendix E.

[7]The trial court held that the attempt to freeze returns at their 1978 levels (under the presumption of Regulation 4040(e)(1)) was confiscatory as a result of its finding that:

> On April 10, 1978, rates of return from rental income on Santa Monica residential rental properties averaged (a) between 1 and 2 percent based upon the owners' equity (*i.e.*, the current value of the property less the outstanding indebtedness); and (b) between 2 and 4 percent on the basis of the owners' historic cash investment.

Appendix E-5.

[8]The trial court held:

> There is no reasonable purpose to be served by the Rent Control Amendment for discriminating between

Thereafter, in response to a request by the City, the trial court granted the City an opportunity to revise its regulations. The Board adopted Regulation 4100.

Plaintiffs challenged Regulation 4100 in the so-called Phase II of the trial. As Regulation 4100 was new, there were no Board decisions implementing or interpreting the Regulation at the time of the trial. Therefore, the trial on Regulation 4100 was a "facial" challenge rather than an "as-applied" challenge. Nonetheless, unlike the Charter Amendment itself, Regulation 4100 is explicit in its application, leaving no room for Board interpretation and enabling the expert witnesses from both sides to agree on the returns that would be permitted under Regulation 4100.

The testimony and analysis of the respective experts in Phase II of the trial agreed with one major exception—the Defendants' experts assumed that, within 10 to 20 years, the owners would be entitled to demolish the improvements on their properties and would then realize the allegedly far higher value of the vacant land.[9] Defendants' experts combined the annual returns with their assumed large capital gains to be realized upon relatively prompt demolition and computed (with appropriate reductions to present value) modest, but arguably constitutional returns.

Plaintiffs' experts did not include in their computations the realization of such capital gains upon demolition as the Rent Control law itself prohibited such demolition and alternative uses. In addition, Plaintiffs argued that a

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> similar properties on the basis of factors personal to the particular person who owned the property on April 10, 1979, including his cash investment, his particular terms of financing and his tax bracket.

Appendix E-5.

[9]According to the Defendants' own experts, under the Rent Control Charter Amendment and the Board's regulations, the value of the vacant land would soon exceed the combined value of the land together with the rent-controlled structure on it.

confiscatory rate setting schedule cannot be saved from constitutional deficiency by the assumption that the Plaintiffs will, in a decade or two, be able to make alternative uses of their property at great economic gain. Plaintiffs' experts therefore calculated the returns considering only the income stream generated by the rents themselves under Regulation 4100. Under this methodology, the Plaintiffs' experts calculated returns to owners to be between two and six percent on the pre-rent control, 1978 values of their properties.

In its decision in Phase II, the trial court held that Plaintiffs had not met their burden of proof that the application of Regulation 4100 would necessarily be confiscatory for a significantly large number of owners. As this decision was further explained in the trial court's decision in Phase III A, the court's ruling was founded on the Defendants' own theory of the ability of the owners to make alternative uses of their properties. At the time of the decision on Phase II, however, the validity and effect of the prohibitions against removal remained bifurcated and reserved for a subsequent trial.

In its decision in both Phase I and Phase II, the trial court ruled that it was the judicial function to consider only the results of the various methods of regulating rents adopted by the administrative rent control boards. The trial court further ruled that, in any court's consideration of these results for constitutional sufficiency, the court is to apply a separate, constitutional test for confiscation. While administrative methods may employ a virtual smorgasbord of different methods for determining rent levels, the constitutional test applied by the courts for measuring whether the return is confiscatory must consider the value (under some appropriate definition) of the property upon which the rent schedule is imposed. (Statement of Decision, Phase II (Appendix G-13, G-14)). The trial court found it unnecessary to enunciate this constitutional test with any degree of detail.

The third phase of the trial concerned primarily the prohibition against the removal of rental units. After Phase

III of the trial, the trial court struck down the Rent Control Charter Amendment's prohibitions against the removal of rental units on what might be considered to be technical grounds.[10]

Once again the City was given the opportunity to revise the law. This time, the City adopted an ordinance[11] curing the technical problem by permitting removal whenever an owner could prove that he would be unable to receive a non-confiscatory return by retaining the property as rental housing. In actual effect, however, the prohibitions against removal were not relaxed.

In the fourth phase of the trial (denominated "Phase IIIA"), the trial court considered the effect of the prohibition against removal in light of the defense asserted by the Defendants in the second phase of the trial that the owners' ability to make other uses of the property was the only factor that saved Regulation 4100. In its ruling on Phase IIIA, the trial court held that where, as here, the only argument or evidence supporting the non-confiscatory nature of the rent levels was the owners' ability to make alternative uses of their properties, the City could not turn around and prohibit such alternative uses.

> Defendants have not contended in Phases II, III, or III A that net operating income alone under

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[10]As drafted, the Charter Amendment permitted removal only when the owner could prove that he could not earn a non-confiscatory return by retaining the property as rental property *and* that, *inter alia*, there were no low income families residing in any of the rental units. Under well-established federal law relating to public utilities, an entity has a constitutional right to withdraw from a regulated activity if it can prove that it cannot earn a non-confiscatory return by remaining in the regulated activity. *Brooks-Scanlon Railroad Co. v. Railroad Commission*, 251 U.S. 396 (1920).

[11]Ordinance 1255, attached hereto as Appendix N. The Rent Control Charter Amendment was itself subsequently amended to reflect the language adopted in the ordinance. Therefore, Phase III of the trial court's decision is admittedly moot.

> Regulation 4100 allows a constitutional return to owners. Defendants' experts testified that the combination of net operating income together with eventual capital gain would yield a non-confiscatory return.
>
> . . .
>
> Since the constitutionality of Regulation 4100 rents depends upon the ability of an owner to eventually demolish his building (according to defendants' arguments in Phases II and III), the City of Santa Monica cannot simply refuse a removal permit to an owner in the fashion set forth in the Replacement Ordinance. Defendants' logic is circular. If owners may be restricted to lower rents than the market would bring because eventually they will receive removal permits, then the City cannot refuse to grant removal permits because the owners can still collect the lower rents.

Announcement of Intended Decision, Phase III A, Appendix J-7, J-8. The trial court specifically did not hold that such prohibitions were unconstitutional per se or that such controls would be unconstitutional whenever combined with rent controls.

In the Judgment, the trial court issued an injunction against the City, prohibiting it from enforcing the prohibitions against removal. The trial court permitted the City to request a reconsideration of the injunction if the City revised the rent regulations to permit owners to receive greater returns from the rents themselves. This injunction was stayed by the Court of Appeal and eventually vacated as a result of the appellate court's decision.

D. Decision of The California Court of Appeal.

The California Court of Appeal, in an opinion written by Superior Court Judge B. Mills[12], reversed the trial court, and held that fair market value—however and whenever measured—is not the test by which the constitutionality of returns is measured. Instead, the court of appeal looked to zoning cases and embraced the standard from these cases for a constitutional "taking."

> Even a significant diminution in value is insufficient to establish a confiscatory taking (*Euclid v. Ambler Realty Co.* (1926) 272 U.S. 365 [75 percent reduction in value because of zoning law insufficient to establish taking]; *Hadacheck v. Sebastian* (1915) 239 U.S. 394 [nearly 90 percent reduction in value because of use restriction insufficient to establish a taking]).

181 Cal. App. 3d at 982, Appendix A-13.

In other words, under the logic of the court of appeal's decision a rate may be constitutional even if it were so low as to reduce the market value of the regulated property by up to 90 percent. In effect, such a rate would provide a just and reasonable return only on the remaining 10 percent of the value of the property. The trial court had expressly rejected and distinguished this attempted insertion of the law applicable to zoning and land use cases to rate regulation cases. Appendix D-8.

The court of appeal also reversed the trial court's determination that Regulation 4040 violated the owners' equal protection rights as the Regulation treated otherwise identical properties substantially differently depending solely upon the means and financing of the acquisition of the property by whoever owned it on April 10, 1978. (Appendix D-22). The court of appeal relied upon another court of appeal decision, *Cotati Alliance for Better Housing v. City of Cotati,* 148

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[12]Sitting by special designation of the Chairperson of the California Judicial Council.

Cal. App. 3d 280, 195 Cal. Rptr. 825 (1983), that such unequal treatment was rationally related to the legitimate legislative purpose of maintaining the lowest rent levels.[13]

Finally, the court of appeal reversed without discussion the trial court's determination that, without the additional income from the eventual alternative uses of the properties, Regulation 4100 denied owners a constitutional return.[14] Since the court of appeal found that Regulation 4100 allowed constitutional returns even without including the alleged additional value upon demolition, the court of appeal reversed the trial court's ruling regarding the prohibition against demolition and vacated the trial court's injunction.

THE FEDERAL QUESTIONS PRESENTED ARE SUBSTANTIAL.

This case confronts the question of the judicial role in protecting citizens from constitutionally confiscatory rate

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[13]*Cotati Alliance for Better Housing v. City of Cotati*, 148 Cal. App. 3d 280, 292, 195 Cal. Rptr. 825 (1983)(holding that, "[i]t is 'at least debatable' in the present case that the return on investment standard bears a rational relationship to a legitimate public purpose. The investment-based standard, unlike a value-based standard, ensures that inflationary factors will not be built into a rent control ordinance's rent ceiling adjustment mechanism, and thereby ensures the integrity of the entire rent control scheme.")

[14]The court of appeal's decision is somewhat vague on this point. The court's complete analysis on this entire phase of the trial is as follows:

> "Net Operating Income" standards, such as Santa Monica's (fn. 4, p. 3, *supra*) 4100, et seq. essentially a return on investment standard, have been approved by California courts (see *Cotati, supra*, at p. 289; *Gregory, supra*, at pp. 85-86) including the California Supreme Court in *Fisher, supra*, at pages 680-683.

Appendix A-21.

Of course, Regulation 4100 is *not* in any way "essentially a return on investment standard," and no comparable method has been upheld in these cited decisions, facially, as-applied or otherwise.

regulations. While this and other courts have repeatedly confirmed that the Constitution limits the extent to which income from legal activities may be restricted by government price regulation, there has never been enunciated any basic framework by which the lower courts can apply these constitutional protections. As a result, the decisions in this area are basically ad hoc, without consistent analysis and providing little or no guidance for the next litigant. While such ad hoc decision making may provide sufficient constitutional protections for major public utilities, it offers nothing for small landlords and other persons who have inadequate resources to fund such unguided resort to their constitutional protections from confiscatory rate regulation.

A. Rate Case Precedent.

While there are some general guidelines, they are only loosely established and are ignored in practice as often as they are followed. In the seminal case, *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 575 (1942), this Court emphasized that it was not the function of the judiciary to determine the wisdom or folly of any particular rate established by an administrative agency, but merely to determine whether the rates were sufficient to avoid a claim of constitutional confiscation. Thus this Court cautioned that the judiciary should not review the item-by-item, line-by-line determinations of the administrative agencies, but instead should consider only whether the *results* of the particular administrative method for setting rates were confiscatory. "The fact that the method employed to reach that result may contain infirmities is not then important." *Id.* at 602.

The obvious question is left unanswered by the *Hope* decision: How does the judiciary measure these results for constitutional sufficiency? Are the courts to utilize whatever test was devised by the administrative body itself and merely to observe whether there was substantial evidence to support the findings? If this were the judiciary's role in ensuring constitutional protections, then every national and local

administrative agency with rate setting authority would, in effect, be enunciating a constitutional standard whenever it adopted one method or another for rate setting purposes.

Plaintiffs respectfully suggest that a review of judicial decisions involving agency rate setting determinations fails to yield any consistent analysis of these cases. In some cases the courts seem to limit their review to whether the agency's determination is arbitrary and capricious. ". . .The [FCC] is free to make its own calculation of what would constitute an adequate rate of return, and we will uphold that calculation as long as it meets the statutory requirements and is not arbitrary or capricious." *Alabama Power Co. v. Federal Communications Comm'n,* 773 F.2d 362, 372 (D.C. Cir. 1985). Other cases involve a detailed analysis of the agency's methodology. *Farmers Union Central Exchange, Inc. v. Federal Energy Regulatory Comm'n,* 734 F.2d 1486 (D.C. Cir. 1984).

This Court has recently heard argument in the latest of these cases, *Florida Power v. Federal Communications Comm'n,* 772 F.2d 1537 (11th Cir. 1985), *prob. juris. noted,* ___ U.S. ___, 90 L.Ed. 2d 716 (1986). In the *Florida Power* case, the owner was required by the Federal Pole Attachment act to continue to rent space on its poles to its cable television "tenants." The rent for the space was regulated by the FCC.

Substituting the term "apartment" for the term "pole attachment," the issues of that case are virtually identical with those presented here. However, where the Eleventh Circuit stopped short, holding that the compensation could only be determined by the judiciary, this case raises the next question not addressed by the Eleventh Circuit—if the rate can be initially established by the administrative agency, how does the court review the rate to protect against confiscatory rate setting?[15]

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[15]This is not to suggest that such a constitutional standard would be so specific as to dictate the result of its application in each case. The standard as perceived by Plaintiffs is merely a logical

B. The Constitutionality of Rent Controlled Returns.

Except for the present case, all or almost all cases in both federal and state courts concerning rent control have involved facial attacks to broadly-worded ordinances or statutes. In essence, they have all been premature and the decisions have been merely variations of this Court's decision in *Yakus v. United States,* 321 U.S. 414 (1944), holding that the courts cannot presume that an administrative agency will act unconstitutionally. Therefore, the scope of review in these cases has only been whether the law is broad enough to admit to some possible constitutional interpretation. As a consequence, virtually all law on the topic has been dicta added by the courts to assist the administrative agencies to a constitutional interpretation of the law. This Court itself has considered rent control only under similar overbroad challenges. *Bowles v. Willingham,* 321 U.S. 503 (1944); *Block v. Hirsch,* 256 U.S. 135 (1921). While the underlying topic was rent control, *Fisher v. City of Berkeley,* ___ U.S. ___, 89 L.Ed. 2d 206 (1986) involved anti-trust issues and not rent control issues.

1. Constitutional Test vs. Administrative Standard.

This Court has repeatedly stated that in reviewing administratively established rates for confiscation, it is only the result that counts. However, until the California Supreme Court, first in *Carson Mobilehome Park Owners' Ass'n v. City of Carson,* 35 Cal. 3d 184, 197 Cal. Rptr. 284, 672 P.2d 1297 (1983) and later in *Fisher v. City of Berkeley,* 37 Cal. 3d 644, 209 Cal. Rptr. 682, 693 P.2d 261 (1984), *aff'd other gds,* ___ U.S. ___, 89 L.Ed. 2d 206 (1986), made a distinction between administrative standards and the constitutional test by which the results are measured, there seemed to be no

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methodology which would still be subject to determination on the basis of the circumstances, locality, and risk. *See, e.g., Willcox v. Consolidated Gas Co.*, 212 U.S. 19 (1909).

coherent analysis of rate setting cases. These California decisions, while still avoiding the critical question of the substance of the constitutional test against which the returns will be measured, have nonetheless inserted logical structure into judicial review of rate regulation cases.

In *Fisher*, the California Supreme Court expressly avoided any decision regarding the substance of the constitutional test on the ground that the case then before it was merely a facial attack with neither specific regulations nor specific economic facts.

> As is apparently conceded by both parties, it would be premature and problematic for us to attempt to articulate, in the context of this facial attack, the constitutional test against which specific applications of various administrative standards are to be judged. We will face that question when we review a challenge to rent control as applied to particular plaintiffs. It is sufficient in this case to measure defendants' fair return on investment standard against the general proposition that an administrative standard must be such that it will permit those who administer it to avoid confiscatory results.

37 Cal. 3d at 681, n. 35.

In the instant case, although the court of appeal had a massive as-applied challenge before it, it declined even to make the necessary constitutional test/administrative standard distinction, returning again to unstructured, ad hoc review.

2. Constitutional Test.

The first court to attempt to wrestle with the critical question of constitutional confiscation in the rent control context was the New Jersey Supreme Court in *Troy Hills Village v. Township Council of the Township of Parsippany-Troy Hills*, 68 N.J. 604, 350 A.2d 34 (1975). In dicta, the New Jersey court stated:

> We perceive that deciding whether a rent regulation permits a just and reasonable return requires consideration of the value of the rental property, the reasonable expense of operating the property, the income, the rate of return on the value of the property actually permitted by the rent regulation, and the minimum rate of return which would be just and reasonable for that property.

350 A.2d at 43.

The New Jersey Court recognized two essential factors in this test: First, the court noted that "Courts should not be concerned with balancing competing interests and determining what is the 'best' rate level. Rather, their sole task is to determine the lowest constitutionally permissible rate." (*Id.*) Second, the court stated that the concept of "value" can be circular when used in a rate-setting situation. Value cannot, of course, in a rate setting context be merely measured by the capitalization of income or the measurement will become circular. Instead, the New Jersey Supreme Court suggested:

> Hence we employ the term "value" in the present context to refer to the value of the property in a rental housing market free of the aberrant forces which led to the imposition of controls. Where inflated rents are the result of a housing shortage, "value" refers to the worth of the property in the context of a hypothetical market in which the supply of available rental housing is just adequate to meet the needs of the various categories of persons actively desiring to rent apartments in the municipality.

350 A.2d at 44.

In *Troy Hills,* the New Jersey court did not make the distinction between the constitutional test and the administrative standards. As a consequence, every local rent control board believed it was mandated by the court to apply this complex, detailed test in each case before the local board

involving a request for a rent increase. The result was that the local boards were overwhelmed with the complexity of the test.

In 1978, in *Helmsley v. Borough of Fort Lee,* 78 N.J. 200, 394 A.2d 65 (1978), the New Jersey court acknowledged that it had made an error in *Troy Hills,* but compounded the error by blaming the constitutional test that it had enunciated rather than placing the blame where it belonged—on the court's own failure to make clear to the administrative agencies that the test was only of constitutional significance, to be applied by the courts and not necessarily to be applied by each and every local agency.

As a consequence, the New Jersey court abandoned its previous definition of a constitutional return and returned to the ad hoc method, with no enunciated principle or standard to guide other courts in other cases. The New Jersey court did, however, strike down a portion of the Fort Lee ordinance which set each owner's rate of return equal to the owner's mortgage rate. As older mortgages generally had a lower mortgage rate, the court held that such discrimination violated the owners' equal protection rights.

> Similarly circumstanced landlords, however, must be treated alike. Discrimination based upon the age of mortgages serves no legitimate governmental purpose.

394 A.2d at 80-81.

Thus, the courts have been groping for an appropriate standard since *Helmsley.* The present case contains all of the necessary ingredients—facts, actual applications, and expert testimony and analysis—for the determination of such a standard. Unfortunately, the decision below inserts the land use constitutional standard which, Plaintiffs submit, is completely inappropriate for rate regulation cases.

CONCLUSION

Petitioners respectfully request that this Court note probable jurisdiction.

Respectfully submitted,

STEPHEN L. JONES
GEORGE KIMBALL
of LATHAM & WATKINS

APPENDIX

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL
FOR THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION THREE

JAMES W. BAKER, et al., Plaintiffs and Respondents, v. CITY OF SANTA MONICA, et al., Defendants and Appellants.	2d Civ. No. B 015 599 (Super. Ct. No. WEC 058 763)
SANTA MONICANS FOR RENTERS' RIGHTS, et al., Intervenors.	2d Civ. No. B 015 599 (Super. Ct. No. WEC 059 251)
JOHN J. STEIN, et al., Plaintiffs and Respondents, v. CITY OF SANTA MONICA, et al., Defendant and Appellant.	COURT OF APPEAL - SECOND DIST. F I L E D MAY 30 1986 CLAY ROBBINS, JR. Clerk Deputy Clerk
SANTA MONICANS FOR RENTERS' RIGHTS, et al., Intervenors.	

APPENDIX-A

APPEAL from a judgment of the Superior Court of Los Angeles County. Richard A. Lavine, Judge. Reversed.

Robert M. Myers, City Attorney, Stephen S. Stark, Assistant City Attorney, Karl M. Manheim and Marsha Jones Moutrie, Deputy City Attorneys, for Defendant and Appellant City of Santa Monica.

Joel Martin Levy, General Counsel and Hadassa K. Gilbert, Staff Attorney, for Defendant and Appellant Santa Monica Rent Control Board.

Stephen I. Jones, Latham & Watkins, George Kimball for Plaintiffs, Respondents and Cross-Appellants.

Defendants and appellants City of Santa Monica and the Santa Monica Rent Control Board, Plaintiffs, Respondents and Cross-Appellants John J. Stein and James W. Baker appeal from a judgment upholding Board's standards for determining rent increases, but permanently enjoining defendants and appellants from "regulating or prohibiting, directly or indirectly, demolitions of controlled rental housing."

FACTUAL AND PROCEDURAL BACKGROUND

On April 10, 1979, the City of Santa Monica (City), responding to a housing crises in which much of its rental stock had been razed, by initiative added a Rent Control Law to its City Charter providing basically the following:

- established an elected Rent Control Board (Board),
- instituted a rent roll-back and freeze,
- required the Board to establish procedures,
- prohibited evictions, and
- imposed controls on removals and demolitions.

On the very next day James W. Baker (Baker) filed a taxpayer's suit against City, Board and others, challenging the validity of the rent control law and the regulations promulgated pursuant to it and seeking a mandatory injunction and declaratory relief. A later mandamus action brought by John J. Stein (Stein) and raising similar issues was consolidated with it.

Soon after filing the complaint, Baker requested a preliminary injunction to enjoin the rent control law. The motion was denied on July 13, 1979. A preliminary injunction to enjoin the rent roll-back provisions was denied on September 5, 1979. A pretrial statement and order was entered on November 18, 1980, in which the following issues were identified for trial:

1. whether the rent control law on its face or as applied satisfies the constitutional standards for "just and reasonable return on property", as required by the California Supreme Court in *Birkenfeld* v. *City of Berkeley* (1976) 17 Cal.3d 129,

2. whether the Board's administrative procedures afford landlords due process,

3. whether the rent control law impermissibly discriminates among several situated properties, thereby denying landlords equal protection of the laws,

4. whether the rent control unconstitutionally diminishes the value of rental property, and

5. whether the Board may constitutionally regulate the removal of rental units.

The case was eventually set for trial on December 2, 1980, and tried in four phases[1] over a two and one-half year period.

In Phase I the trial court considered the validity of Regulation 4040 which allowed rent increases based on a

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[1]Each phase was followed by a Memorandum of Intended Decision and Findings of Fact and Conclusions of Law (or Statement of Decision).

landlord's original cash or "historic investment" in the property and referred to as the "fair return on investment standard". On July 27, 1981, the court signed Findings of Fact and Conclusions of Law[2] determining that City's standard was unconstitutional because it did not allow a fair return based on the fair market value of properties.[3]

The trial court honored a request by City to cure any deficiencies in its rent standards and allowed promulgation of new "fair return" standards to be submitted for further hearing. A new regulation (4100) employing a "net operating income" (NOI) approach was promulgated.[4]

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[2]The principal Findings and Conclusions were:

1. The "fair return on investment" standard denied landlords equal protection (Finding 16) without reasonable basis (Finding 17; Conclusion 8), and produced widespread, confiscatory results (Conclusion 7).

2. Rent control halted the appreciation of rental property values (Findings 21, 23, 35), resulting in confiscation of that aspect of the market value attributable to appreciation (Findings 25, 26).

3. General rent adjustments of 7 percent in 1979 and 6.5 percent in 1980 were insufficient to avoid widespread confiscatory results (Finding 32), and the Board was constitutionally required to award rent increases in excess of the Consumer Price Index (Finding 34).

4. Landlords were constitutionally entitled to cash returns on their property greater than the returns on public utility stocks (Finding 39).

5. Stricter constitutional standards apply to rent control legislation than to zoning ordinances (Conclusion 6).

6. Landlords were entitled to a return based on the fair market value of their properties as defined by Code of Civil Procedure section 810, et seq. (Conclusions 9, 11).

7. Regulation 4040 and its authorizing provisions in the City Charter were unconstitutional (Conclusion 18).

[3]Return on investment standards have been subsequently approved in *Fisher* v, *City of Berkeley* (1984) 37 Cal.3d 644, *infra* at p. 35.

[4]Under this plan rents are raised to cover increases in operating expenses and to allow increases in profit commensurate with inflation. Annual "general" (across-the-board) increases and "individual" (hardship) increases are allowed. (§ 1805.)

In Phase II the constitutionality of Regulation 4100 was tried and on February 17, 1982, in its Announcement of Intended Decision the court determined that the new provisions violated neither the California nor the Federal Constitutions.

In Phase III the constitutionality of the removal aspects (Charter § 1803(t)) of the Rent Control Law was tried. The court found the provisions facially invalid under the doctrine of *Brooks-Scanlon Co.* v. *Railroad Commission of Louisiana* (1920) 251 U.S. 396, 399 (a regulated utility could not be compelled to continue operation if it could only operate at a loss), ruling that criteria for a removal permit based on impact on the housing stock could not be imposed consistent with that doctrine.

The court again allowed City an opportunity to promulgate a corrective regulation. On August 12, 1982, following an ordinance enabling same, Board adopted regulations to satisfy the *Brooks-Scanlon* requirements and to replace section 1803(t), requiring the granting of a removal permit if the Board "determines that the landlord cannot make a fair return as constitutionally defined by retaining the controlled rental units on the rental housing market."

A hearing (Phase IIIA) was held to determine the validity of the ordinance. The court ruled that it was unconstitutional,[5] being violative of due process because it provided no widespread, across-the-board mechanism to relieve the vast majority of landlords without the necessity of individual hearings; further, that the removal restrictions were preempted by state policy regarding housing development.[6]

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[5]Section 1803(t) was subsequently approved by this division in *Blue Chip Properties* v. *Permanent Rent Control Bd.* (July 1985) 170 Cal.App.3d 648, citing the California Supreme Court's prior partial approval as applied in *Nash* v. *City of Santa Monica* (Oct. 1984) 37 Cal.3d 97, 103.

[6]The court found:

1. "The controls on demolition failed to yield a constitutional, i.e. non-confiscatory return under *Birkenfeld* v. *City of Berkeley*

By judgment filed July 14, 1983, the court enjoined City and Board ". . . from regulating or prohibiting, directly or indirectly, demolition of residential rental housing"[7] . . . with certain limited exceptions, i.e. to ensure public safety, allow tenants time to seek alternate housing or upon showing that ". . . economic considerations are not a substantial factor in the owner's intentions in filing . . ." the permit.[8] Motions for stay of execution were made and denied. This court granted a writ of supersedeas on October 18, 1983.

CONTENTIONS

City and Board contend that: The trial court erred in enjoining enforcement of the removal portion of the rent control law because: it misapplied the law (essentially the Supreme Court's holdings in *Birkenfeld* v. *City of Berkeley*

. . . ."

2. "The replacement ordinance effectively blocks (new) construction of buildings with more units than presently exists. Hence, it is contrary to state policy as enunciated by the state legislature. (See concurring opinion of Judge Marshall in *The Pines* v. *City of Santa Monica* (1981) 29 Cal.3d 656, 664-665.)"

3. "The lack of a generally self-executing across-the-board removal process (akin to the general adjustment for rent increases) deprives landlords of due process in violation of *Birkenfeld*."

[7]The court gave as its reasons:

"This court has considered the analogy that there are two spouts and two corks on the steam kettle of the entire plan of rent control in Santa Monica. One cork restrains owners from 'releasing steam' by raising current rents. The second cork prevents owners from realizing capital gains by demolishing the property and putting it to a higher economic use. If the city chooses to release pressure under the first cork, then it would be logical to permit the city to tighten the cork on the second spout which controls demolition."

[8]The injunction permitted City and Board "To enact a regulation providing that if, within 45 days of the filing of an application for demolition permit, the city makes a good faith finding based upon clear and convincing evidentiary testimony that economic considerations are not a substantial factor for a demolition permit, the city may then, and only then, reject such application; . . ."

(1976) 17 Cal.3d 129) in determining that a municipal rent control ordinance must guarantee to owners: (a) fair return on the *value* of their *property*; (b) protected anticipated appreciation; (c) self-executing or ministerial procedures for removal via demolition or change of use, and (d) protection from the combination of rent ceilings *and* removal restrictions.

Baker and Stein contend that: (e) The trial court erred in not finding Regulations 4100-4111 unconstitutional on their face because they will necessarily fail to allow a substantial number of efficient landlords a just and reasonable return on their properties.

SUMMARY

Except for its decision that Regulations 4100-4111 are constitutional, the trial court misapplied the holdings and dicta of *Birkenfeld, supra*, to impose "return" and "removal" standards upon City and Board which are too stringent, not required by any known precedent, and therefore dictating a reversal.

DISCUSSION

The basic question on this appeal is: Did the trial court apply the proper constitutional standards in its analysis of the rent ceiling and removal restrictions of the Santa Monica rent control provisions? We determine here that it did not. On occasion a studious judge selects from the books a legal intimation and with it constructs housing for the case, only later to learn that what he adopted as a plan was instead just the primitive etchings of an earlier builder who now, joining others with the collected developing force of a stormy sea, beats the building into the beach. Since entry of the judgment below, enjoining enforcement of portions of the rent control law, the infrastructure on which its holdings were based has been demolished by several significant subsequent appellate cases. Its reliance upon fair market value standards for determining a "fair and reasonable return" to landlords permeates and affects the entire decision of the trial court.

It is clear that the court adopted the "fair market value" standard very early in the proceedings. In its Memorandum of Intended Decision of March 6, 1981, is written:

> "The Rent Control Ordinance and its implimenting regulation 4040 allegedly are founded upon the theory that the property owners are entitled to no more return than that which is calculated upon the historical investment of each particular landlord measured at the time the landlord acquired his property. But *Birkenfeld*[9] teaches at page 165 that 'The provisions are within the police power if they are reasonably calculated to eliminate excessive rents and at the same time *provide landlords with a just and reasonable return on their property.*' (Emphasis added.)"

Thereafter, and throughout the subsequent proceedings, references were made to that standard in memoranda, punctuating its significance in other determinations; (e.g. see citation of Evidence Code section 811, defining "value of property" to mean "market value"; holding that "historical investment" is a constitutionally impermissible standard; holding, for purposes of preserving the constitutionality of a portion of the adjustments section, "return on investment" to mean "return on property" (Phase I); disagreeing with the "unworkable circularity" of "value based criterion" analysis of *Helmsley* v. *Borough of Fort Lee* (1978) 78 N.J. 200, 394 A.2d 65 (Phase II Memorandum of Intended Decision, Feb. 17, 1982); determining, in effect, that section 1803(t) precludes the realization of reasonably anticipated increase in value at the end of the holding period (Phase III, Memorandum of Intended Decision, June 18, 1982): holding in the Judgment of July 14, 1983, that Fair Market Value is the mandated standard.

a. The Trial Court Erred in Concluding that Fair Market Value is the Standard Mandated for Determining a Fair Return to Landlords

Any reliance upon the Fair Market Value standard for these purposes is seriously misplaced. Recently it has been rejected by the courts considering it. (*Cotati Alliance for Better Housing* v. *City of Cotati* (Oct. 1983) 148 Cal.App.3d 280, 287.) Originally employed by the United States Supreme Court in an early railroad rate case (*Smyth* v. *Ames* (1897) 169 U.S. 466), it was later rejected because, ". . . rates cannot be made to depend upon 'fair value' when the value of the going enterprise depends on earnings upon whatever rates may be anticipated." (*Power Comm'n* v. *Hope Gas Co.*. (1943) 320 U.S. 591, 601-602; see generally *Fisher* v. *City of Berkeley*(1984) 37 Cal.3d 644, fn. 33, p. 680.) California appellate courts have been consistent in the rejection.

In *Palos Verdes Shores Mobile Estates, Ltd.* v. *City of Los Angeles* (Apr. 1983) 142 Cal.App.3d 362, Division Five of this District found nothing in *Birkenfeld, supra,* that would guarantee to landlords a fair return on the present fair value of their property and noted its specific rejection in rent control cases. (*Ibid.*, p. 370, citing *Hemsley* v. *Borough of Fort Lee, supra,* at p. 72, as stating: ". . . a value-based criterion for confiscation under rent control is practically unworkable.")

The Fifth District of this court stated in *Cotati, supra*: ". . . We reject landlord's contention that a 'return on value' standard is mandated in order for a rent control ordinance to pass constitutional muster. The fatal flaw in the return on value standard is that income property most commonly is valued through capitalization of its income. Thus, the process of making individual rent determined by rental income, the amount of which is in turn set according to value. Use of a return on value standard would thoroughly undermine rent control, since the use of uncontrolled income potential to determine value would result in the same rents as those which would be charged in the absence of regulation. . . . Rent control utilizing this standard is no rent control

at all." (148 Cal.App.3d 280, 287.) (*Gregory* v. *City of San Juan Capistrano* (Apr. 1983) 142 Cal.App.3d 72, was criticized for concluding that the return on value standard is required based upon *Birkenfeld* and *Helmsley, supra.*)

In *Oceanside Mobile Home Park Owners' Assn.* v. *City of Oceanside* (June 1984) 157 Cal.App.3d 887, the Fourth District of this court concurred with the opinions in both *Cotati* and *Palos Verdes Shores, supra,* in rejecting the contention that such a standard is constitutionally required. (*Id.*, p. 898.) It stressed the process' inevitable circularity, citing *Helmsley, supra.*

Then the California Supreme Court in *Fisher* v. *City of Berkeley* (Dec. 1984) 37 Cal.3d 344, after concluding that rent control agencies are not obliged by either the state or federal Constitution to fix rents by application of any particular method or formula (at p. 680), provided some sense of direction regarding the selection of standards, but no support for the choice of the trial court in this case. In rather telling footnotes it observes, inter alia: that circularity problems exist when fair market value concepts are applied in the rent control context; that use of such a standard would thoroughly undermine rent control (*id.*, p. 681) and finally stating:

> "[W]e wish to dispel suggestions based on dictum in *Birkenfeld* that we have previously established, as a constitutional test, a requirement that rent controls must provide landlords a 'just and reasonable return on their property'. . . . This statement was made in the context of a broader discussion of the legitimate exercise of local police power, and was most certainly not intended to articulate a constitutional standard. Birkenfeld's reference to the term 'property' should therefore be viewed with caution; it would be inappropriate to suggest that the *Birkenfeld* statement can be used to predict the specific constitutional standard that

we will articulate when we review a challenge to rent control as applied." (*Id.*)

The trial court simply misapplied the Supreme Court's dictum in *Birkenfeld* in concluding that rent control law must guarantee owners a fair return on the value of their properties.

b. The Trial Court Erred in Concluding that Constitutional Requirements Mandate that a Rent Control Ordinance Guarantee to Owners Anticipated Appreciation

In addition to its position that return on value of property is a proper standard, the trial court would extend the significance of that value to the present and future on the belief that its appreciation is constitutionally protected, in other words, that the reasonableness of rents is dependent upon appreciation of that value. In its judgment of July 14, 1983, the trial court found:

> "10. The net rental income realized by landlords on April 10, 1978, did not provide them with a just and reasonable *return on the value of their property if anticipated appreciation be excluded* . . .
>
> "12. Sections 1805(f) and (g) are unconstitutional in that they:
>
> "(a) deny owners their constitutional right to a just and reasonable return on their property; . . .
>
> "(c) appropriate *past return in the form of appreciation*. . . ." (Emphasis added.)

Further, in its Announcement of Intended Decision Phase IIIA of December 29, 1982, the trial court stated:

> "The City cannot have it both ways. If the City had been unable in Phase II to show the likelihood that the owners may eventually realize a *capital gain at the time of demolition*, then this court would have declared regulation 4100 unconstitutional in

> view of the low net operating income permitted to owners in contrast to returns on other types of investment. . . ."

It then found:

> ". . . [U]pon the basis of all of the economic evidence offered in the case that the existence of such demolition controls does not provide a constitutional, i.e. non-confiscatory[,] return to the large majority of the owners of controlled rental housing in Santa Monica."

From these portions of the record it is clear that the trial court based the ultimate finding that the combined effect of rental control and removal restrictions is confiscatory upon the perception that the removal restrictions eliminate the capital gain (appreciation) portion of the total return. Once again, the trial court's handiwork is undone by intervening subsequent appellate decisions, indicating not only a lack of constitutional protection for appreciation, but rather considerable sufferance of *depreciation* in a rent control context.

The *Cotati, supra,* court stated at page 290: "Landlords argue that the investment-based standard of the ordinance unfairly deprives [them] of any long-term appreciation in the value of their property. Some lessening of appreciation is a necessary consequence of any rent control, since future appreciation is to a significant extent a function of increased rental income. (See *Helmsley* v. *Borough of Fort Lee, supra,* at p. 72 [rent control "limits the potential growth of . . . income stream, and also therefore, the potential capital appreciation on re-sale."].) It is one of the very sources of long-term appreciation-inflated rents-that rent control measures are intended to restrict. The *Fisher* court cites *Cotati* to the same effect, at page 685; and in *Griffin Development Co. v. City of Oxnard* (Aug. 1985) 39 Cal.3d 256, 267, the California Supreme Court "note[s] in *Fisher,* [that] most land use regulations have 'the inevitable effect of reducing the value

of the regulated properties. . . . Such reduction in property value does not, by itself, render a regulation unconstitutional.' Even a significant diminution in value is insufficient to establish a confiscatory taking. (*Euclid* v. *Ambler Realty Co.* (1926) 272 U.S. 365 [75 percent reduction in value because of zoning law insufficient to establish taking]; *Hadacheck* v. *Sebastian* (1915) 239 U.S. 394 [nearly 90 percent reduction in value because of use restriction insufficient to establish a taking].)" (37 Cal.3d at p. 686.) It follows therefore, that a rent control ordinance which does not guarantee anticipated appreciation in property values is not thereby rendered unconstitutional. (See also *HFH, Ltd.* v. *Superior Court* (1975) 15 Cal.3d 508, 520-523 and *Agins* v. *City of Tiburon* (1979) 24 Cal.3d 266, 277 affd., (1980) 447 U.S. 255, 261-262.)

The *Cotati* case also addresses the question of whether the rent control law impermissibly discriminates among several situated properties, thereby denying landlords equal protection of the laws. We conclude that it does not, for the reasons set forth at 148 Cal.App.3d 291:

> "Landlords contend that the investment-based standard will yield disparate returns as between identical properties purchased years apart for widely differing prices. . . . Even if the rents are viewed as the proper measure and disparity is perceived, such disparate treatment does not violate equal protection guarantees. Equal protection is not denied simply because an ordinance treats one class of persons differently from another. Where there is no suspect classification, and purely economic interests are involved, a municipality may impose any distinciton which bears some 'rational relationship' to a legitimate public purpose. (*Hale* v. *Morgan* (1978) 22 Cal.3d 388, 395)."

c. The Trial Court Erred in Concluding that a Municipal Rent Control Ordinance Must Provide Self-Executing or Ministerial Procedures for Removal from Controls via Demolition or Change of Use (Conversion)

Following through on its premise regarding the viability of the fair market value standard and its commitment to the assumptions that any postponement of capital gain under rent controls operates to eliminate appreciation of land value for the period of that postponement and that capital gain can only be realized upon demolition, the trial court concluded that the removal regulations did not allow an owner to demolish when he was not earning a fair return and, therefore, the combined effect of rent controls and removal controls was confiscatory. In other words, to be valid, permitting a fair return, the ordinance must permit the owner to realize the reversionary value of the underlying land at any given time, *at will,* as it were. Besides, reasons the court further, the Board's Category B removal proceedings are unnecessarily burdensome under *Birkenfeld.* Its primary concern was with delay in obtaining that reversionary value under the mechanism.[10] We conclude that the concern is misplaced,

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[10]In its Phase IIIA Statement of Decision, the trial court first paraphrased a portion of the regulations to the effect:

> ". . . that any owner who contends that he or she is not realizing a fair return from a particular unit must assume the onerous burden of proof that the unit does not yield *a total return, i.e. return from net operating income and future anticipated capital gain upon demolition* to satisfy his or her constitutional right to a fair return." (Emphasis added.)

and concluded:

> "In order for any petitioner for Category B removal permit to make an administrative record sufficient to prove his or her constitutional position for reviewing courts upon administrative mandamus review, such owner would have to make a showing involving *many*

upon a careful consideration of the relevant regulations. There is an insufficient showing on the record either that evidence concerning eventual capital gain is required, or that there must be separate hearings for each individual unit, the principal sources of the burden envisioned. They are required neither by the regulations nor the necessary implications of practice, according to the evidence.[11] On the contrary, multiple treatment of units appears to be presumed. The court itself described the standard for calculation as "simple" and "objective".

Again, recent cases are most instructive on the issues raised. The California Supreme Court in *Nash* v. *City of Santa Monica* (1984) 37 Cal.3d 97, 109, stated:

> "[I]n the context of a land-use ordinance the requirement of section 1803, sub-division [t], that

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days of hearing, and much expenditure of attorney's and expert fees, *for each unit he or she owns.* I find that the placing of such a burden would deprive each owner of administrative due process. Because of the time, expense and expertise required, owners could not effectively file and establish these petitions." (Emphasis added.)

[11]The regulations in fact provide:

"[Section] . . . 5012 . . .

"(a) *Category B.*

"The Board shall grant a removal permit if it finds that the current MAR (Maximum Allowable Rent) for the unit does not provide a *fair return* and that the landlord cannot rent the unit at that rent necessary to provide the landlord with a *fair return* . . .

"(e) . . .

"The Board shall grant a Category . . . B . . . removal permit with respect to a rental unit if it finds that the MAR's of individual *units which the landlord owns on the same property* cannot be adjusted so as to enable the landlord to collect an overall fair return. . . ." (Emphasis added.)

> a pre-demolition removal permit must be obtained before a landlord may level his or her rental units is reasonably related to the legitimate goals of maintaining adequate rental housing for Santa Monica's citizens. There can be no doubt that the relationship of the ordinance to the public welfare is both 'real and substantial'."

Thus holding the removal restrictions here constitutional. This division, in *Blue Chip Properties* v. *Permanent Rent Control Board* (July 1985) 170 Cal.App.3d 648, went so far as to approve this section and that combination of subparts which the trial court found so objectionable.[12] It allowed the prohibition of a removal permit even after the owner had reached some stage in the process of conversion, indicating the extent to which courts will endeavor to uphold removal provisions.

The *Nash* court, *supra,* outlined some parameters of an owner's vulnerabilities when exposed to the removal provisions of rent control.

The state Constitution protects the rights of "acquiring, possessing and protecting property. . . ." (Cal. Const., art. I, § 1.) Both federal and state Constitutions protect against deprivation of property without due process of law. Yet, " 'It is thoroughly established in this country that the rights preserved to the individual by these constitutional provisions are held in subordination to the rights of society. *Although one owns property, he may not do with it as he pleases any more than he may act in accordance with his personal*

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[12]Section 1803(t) specifies that the Board may issue a removal permit (a) if the rental units are uninhabitable and incapable of being made inhabitable economically or, (b) if the landlord both owns habitable property and does not wish to rebuild, upon findings that (1) the building is not occupied by persons of low or moderate income, (2) cannot be afforded by persons of low or moderate income, (3) removal will not adversely affect the housing supply, and (4) the owner cannot make a reasonable return on his investment.

desires.' " (*Miller* v. *Board of Public Works* (1925) 195 Cal. 477.) (Emphasis added.) Thus, an ordinance restrictive of property use will be upheld, against due process attack, unless its provisions "are clearly arbitrary and unreasonable, having no substantial relation to the public health, safety, morals or general welfare." (*Euclid* v. *Ambler Co.* (1926) 272 U.S. 365, 395.) (*Nash, supra,* at p. 103.) See also *Groch* v. *City of Berkeley* (1981) 118 Cal.App.3d 518, 525 where demolition controls are required to preserve rental housing; and other jurisdictions in agreement: "If the power to control rents is to mean anything more than an interim measure effective only for the short period needed to convert the entire rental housing stock, it must include by implication the power to make reasonable regulations governing removal from the rental housing market." (*Flynn* v. *City of Cambridge* (1981) 383 Mass. 152, 158.)[13]

Such controls may be viewed as an adjunct to limitations upon eviction which have generally been upheld by the courts, with some limited exceptions. (See *Birkenfeld, supra,* at p. 148.)

We join the trial court in its concern, however, that the practical effect of the removal procedure must not be so "cumbersome and pregnant with unnecessary delay that it will necessarily be confiscatory in many cases, . . ." as proscribed by *Carson Mobilhome Park Owners' Ass'n* v. *City of Carson* (Dec. 1983) 35 Cal.3d 184.

In *Carson*, the California Supreme Court unanimously upheld procedures of an ordinance against the charge that the delays inherent in its provisions for notice, hearing and decision, combined with the lack of any mechanism for a

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[13]In at least one jurisdiction the courts have gone so far as to uphold prohibition against conversion even to the owner's personal use, on the grounds "the Legislature could constitutionally decide . . . that an owner's right to utilize his property must yield to a tenant's interest in keeping his home. . . ." (*Puttrich* v. *Smith* (1979) 170 N.J. Super.Ct. 572.)

general rent adjustment made it unconstitutional under *Birkenfeld.* After pointing out that "property may be as effectively taken by long continued and unreasonable delay in putting an end to confiscatory rates as by an express affirmance of them [citation], the court noted that some delay is inherent in all rent control procedures, but that only those delays which are longer than practically necessary to achieve the legitimate purposes of the legislation are constitutionally proscribed (*Carson,* at p. 192). It then approved a provision allowing the Board a maximum of 105 days to act on an application (*id.,* at p. 193); and in *Oceanside Mobile Home Park Owners' Ass'n* v. *City of Oceanside* (June 1984) 157 Cal.App.3d 887, 901, the Court of Appeal ruled a 110 day delay between application and effective date of rent increase ". . . not substantially greater than is practically necessary and thus, . . . reasonable and constitutionally permissible (citing *Birkenfeld, id.,* at p. 901).

The facts of this case compare favorably with those in *Carson* and *Oceanside.* Certainly the analysis by which the rent adjustment mechanism was found invalid in *Birkenfeld* does not apply here. But even if it did, the Santa Monica process does not subject owners to the enormous procedural barriers to relief which resulted in the invalidation of the *Berkeley* mechanism; e.g. in *Berkeley* each of the 16,000 controlled units seeking adjustments required an individual hearing; there was no express limit on the amount of time within which a decision had to be made; the Board had to decide each case itself; the owner had to simultaneously file a certificate from city building inspection services, etc., including numerous other limitations which placed the Board in a "procedural strait jacket".

Conversely, in this case, under Ordinance 1255, the Board is not only required to make a final decision within 120 days,[14] but does so as a matter of practice; the removal process does

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[14]This requirement was affected by an amendment to the Santa Monica City Charter in November 1984. (Art. XVIII, § 1803(t)(4).)

not *require* the Board to hear separate petitions for each unit and, as a matter of fact, it is abundantly clear from the record that the practice is to treat numerous units in connection with an application; nor does the Board bear the entire burden of the hearings, since Regulation 5014(b) provides for delegation of fair return hearing and analysis to a hearing examiner. In any event, there is no showing that resulting delays were any "longer than practically necessary to achieve the legitimate purposes of (rent control)" as is currently required by the unequivocal language of *Oceanside* and *Carson*. Even though there is no constitutional or other requirement that owners have a self-executing, ministerial or "at will" procedure for removal of their units from rent controls, the mechanism must be such as will avoid unnecessary, cumbersome and confiscatory delay. We cannot find, from the record of this case that either the ordinance, regulations or procedures as applied thereunder are clearly arbitrary, unreasonable and without a substantial relation to the public health, safety, morals or general welfare of the citizens of Santa Monica under *Euclid* v. *Ambler Co., supra.*

Even though Baker, who had never filed a petition with the Board himself, was permitted to speculate (based upon a sample of owner opinions expressed in two seminars which he hosted) that the "highly educated and sophisticated and experienced" landlord would require "at least 80 hours" to complete the 18 page petition, that would hardly appear to be the fault of the City, the Board, the Ordinance and their procedures. According to Baker, the owners' individual difficulties with the petition related to such things as: their improperly maintained or non-existent business records; ". . . fear that giving its (a manager-occupied apartment) proper value and then deducting it as an expense . . . then the expense (being) disallowed, and (owner) shown to have a higher income than really existed"; how much "jeopardy (you are) putting yourself in by establishing such a value"; and ". . . guesswork having to do with what they think the Rent Board would approve, what they think their residents can live with, what they need to survive with. . . ."

Board procedures afford much assistance to owners who have questions, e.g. an "information coordinator" is primarily responsible to help the public, answer questions in person, by phone and in writing and at least one staff attorney, the "officer of the day", is made available to receive legal and technical questions. Referrals are also made to the apartment owners' association. The requirements of *Birkenfeld* are satisfied.

d. The Trial Court Erred in Concluding that Owners are Protected from the Combination of Rent Control and Removal Restrictions

We have been unable to find, nor have we been directed to, any authority whatsoever for the "choice" which the trial court would impose upon City and Board under its "two cork" theory. (See fn. 7, p. 4, *supra.*) That a rent control City should be forced to an election between restraints on raising rents and controls on demolition and use changes is not only exceptional, but unprecedented under the cases. As a matter of fact, precedents point in the opposite direction. In *Griffin Development Co.* v. *City of Oxnard, supra, Fisher* v. *City of Berkeley, supra, Blue Chip Properties* v. *Permanent Rent Control Board, supra, Nash* v. *City of Santa Monica, supra,* the combination of rent controls and removal restrictions was approved without the slightest inference or foreboding of fatal flaw as suggested by the court below. Indeed, *Blue Chip* and *Nash* treated precisely the removal provisions of section 1803(t) with which we are here concerned.

We observe, in passing, that the trial court's misgivings that section 1803(t) and regulations amount to restraints on alienation and violate Civil Code section 711 are now absolved by the holding in *Fisher,* at page 692, that the section was never intended to apply to municipal ordinances, but addresses only private restraint and not government regulations. (See also *Blue Chip, supra,* at p. 656.) Finally, the trial court was correct in holding Regulation 4100 constitutional.

e. **The Trial Court Did Not Err in Finding Regulation 4100-4111 Facially Constitutional**

"Net Operating Income" standards, such as Santa Monica's (fn. 4, p. 3, *supra*) 4100, et seq. essentially a return on investment standard, have been approved by California courts (see *Cotati, supra*, at p. 289; *Gregory, supra,* at pp. 85-86) including the California Supreme Court in *Fisher, supra*, at pages 680-683.

For the reasons set forth at a, b, c, and d above, the judgment is reversed.

CERTIFIED FOR PUBLICATION.

We concur: MILLS, J.*

DANIELSON, Acting P. J.

ARABIAN, J.

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*Assigned by the Chairperson of the Judicial Council.

SUPREME COURT
FILED
SEP 16 1985
Lawrence P. Gill, Clerk
DEPUTY

ORDER DENYING REVIEW

AFTER JUDGMENT BY THE COURT OF APPEAL

2nd District, Division 3, No. B015599

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

IN BANK

JAMES W. BAKER et al., Plaintiffs and Respondents,

v.

CITY OF SANTA MONICA et al., Defendants and Appellants.

SANTA MONICANS FOR RENTERS' RIGHTS et al., Intervenors.

JOHN J. STEIN et al., Plaintiffs and Respondents,

v.

CITY OF SANTA MONICA et al., Defendants and Appellants.

SANTA MONICANS FOR RENTERS' RIGHTS et al., Intervenors.

APPENDIX-B

Petition for review of Responndents JAMES W. BAKER et al. DENIED.

Mosk, J., Lucas, J. and Panelli, J., are of the opinion the petition should be granted.

BIRD

Chief Justice

IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT

JAMES W. BAKER, an individual, ALLAN R. FREEMAN, an individual, and LILI PLUKAS, an individual,

vs.

CITY OF SANTA MONICA, a California charter city; JAMES CONN, DENNIS ZANE, CHRISTINE E. REED, KENNETH EDWARDS, DOLORES PRESS, DAVID EPSTEIN, and WILLIAM JENNINGS, each in his or her official capacity as a member of the City Council of the City of Santa Monica; SANTA MONICA RENT CONTROL BOARD, a California public entity; DAVID FINKEL, NEIL A. STONE, LESLIE LAMBERT, SUSAN PACKER DAVIS, and WAYNE BAUER, each in his or her capacity as a Commissioner of the Santa Monica Rent Control Board,

Defendants.

2d Civ. B 015 599
(Super. Ct. No. WEC 058 763)

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

COURT OF APPEAL-SECOND DIST.
FILED
OV 14 1986
CLAY ROBBINS, JR. Clerk
Deputy Clerk

SANTA MONICANS FOR RENTERS' RIGHTS, an unincorporated association; SANTA MONICA FAIR HOUSING ALLIANCE, a corporation,

Intervenors.

/ / /
/ / /
/ / /
/ / /
/ / /

JOHN J. STEIN, JEANNE LOCKE, an individual, and H. HUDSON DECRAY, an individual, Plaintiffs, vs. CITY OF SANTA MONICA, a California charter city. Defendants. SANTA MONICANS FOR RENTERS' RIGHTS, an unincorporated association; and SANTA MONICA FAIR HOUSING ALLIANCE, a corporation, Intervenors.	2d Civ. No. B 015 599 (Super Ct. No. WEC 059 251)

Notice is given that James W. Baker, Allan R. Freeman, Lili Plukas, John J. Stein, Jeanne Locke, and H. Hudson Decray, and each of them, the plaintiffs above named, hereby appeal to the Supreme Court of the United States from the decision in the above-entitled action of this Court filed on May 30, 1986 and final on October 8, 1986.

/ / /
/ / /
/ / /
/ / /
/ / /

This appeal is taken pursuant to 28 U.S.C. Section 1257(2).

DATED: November 14, 1986

STEPHEN L. JONES
725 E. Figueroa Street
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GEORGE KIMBALL
LATHAM & WATKINS
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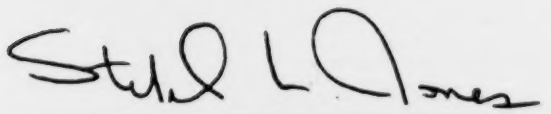
By 

Stephen L. Jones
Attorneys for Appellants

PROOF OF SERVICE BY MAIL

(C.C.P. §§1013a and 2015.5)

I, the undersigned, say: I am and was at all times herein mentioned, a citizen of the United States and a resident of the County of Los Angeles, over the age of eighteen years and not a party to the within action or proceeding, that my business address is c/o Lillick McHose & Charles, 725 South Figueroa Street, Suite 1200, Los Angeles, California 90017, that on November 14, 1986, I served the within NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES on all parties in said action or proceeding by depositing a true copy thereof, enclosed in a sealed envelope with postage thereon fully prepaid in the United States mail at Los Angeles, California, addressed as follows:

CLERK, CALIFORNIA SUPREME COURT
3580 Wilshire Blvd.,
2nd Floor
Los Angeles,
California 90010

JOEL LEVY, ESQ.
Santa Monica Rent
Control Board
1685 Main Street
Santa Monica,
California 90401

JUDGE RICHARD A. LAVINE
c/o Clerk of the
Superior Court
State of California,
County of Los Angeles
111 North Hill Street
Los Angeles,
California 90012
Los Angeles, CA 90012

RON ROUDA, ESQ.
1337 Santa Monica Mall,
#207
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GEORGE KIMBALL, ESQ.
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Los Angeles, CA 90071

JUDGE THOMAS T. JOHNSTON
(Presiding Judge)
c/o Clerk of the
Superior Court
State of California
111 North Hill Street

ROBERT M. MYERS, City Attorney STEPHEN S. STARK, Asst. City Attorney KARL M. MANHEIM MARSHA JONES MOURTRIE, Dep. City Attorney
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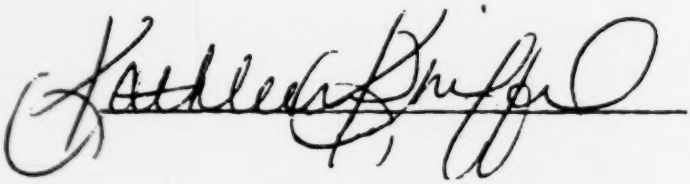
CLERK, CALIFORNIA COURT OF APPEAL
Second Appellate District, Division Three
3580 Wilshire Boulevard, 3rd Floor Los Angeles, California 90010
(by hand delivery)

I am employed in the office of of a member of the Bar of this Court at whose direction the service was made.

I certify (or declare) under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on November 14, 1986 at Los Angeles, California.



Kathleen Kniffel

ORIGINAL FILED

MAR 6 1981

County Clerk

By G. Callahan

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF LOS ANGELES

JAMES W. BAKER, et al.,

Plaintiffs,

v.

CITY OF SANTA MONICA, et al.,

Defendants.

CASE NO. WEC 058763
(Transferred to South Central District)

JUDGMENT

SANTA MONICANS FOR RENTERS' RIGHTS, et al.,

Interveners.

CASE NO. WEC 059251
(Transferred to South Central District)

JOHN J. STEIN, et al.,

Plaintiffs,

v.

CITY OF SANTA MONICA,

Defendant.

MEMORANDUM OF INTENDED DECISION

SANTA MONICANS FOR RENTERS' RIGHTS, et al.,

Interveners.

APPENDIX-D

These consolidated cases came on regularly for trial before this Court, in Department C (presently Department G), on December 3, 1980, Richard A. Lavine, Judge Presiding. After considering all of the evidence heretofore submitted, and briefs and arguments of counsel, the Court makes this memorandum of intended decision.

A. PRETRIAL STATEMENT AND ORDER

A Pretrial Statement and Order, dated November 14, 1980, signed by the parties to this action and the Interveners, and adopted by order of court is incorporated herein insofar as it is applicable. The issues for trial are set forth in Paragraph 5, pp. 3-6 incl., of such Pretrial Statement and Order. These issues will be later addressed more specifically.

B. INTRODUCTION

On April 10, 1979, the majority of the electorate voting in the City of Santa Monica voted in favor of an amendment to the Santa Monica City Charter which established a rent control system. This will be referred to hereafter as the "Rent Control Amendment."

The Rent Control Amendment has been described and summarized by one of defendants' expert witnesses, Professor David Shulman, in Exhibit 226, on p.5 as follows:

"There are essentially nine fundamental provisions in the charter amendment. They include:

"1. A 120 day rent freeze after passage.

"2. Establishing a five member elected rent control board.

"3. A rent rollback of the April 1978 rent level after the freeze and establish that rent level as the base rent.

"4. Establishing a procedure for general and individual rent increases based on costs and 'fair return on investment'.

"5. Disallowing the consequences of negative cash flow on building purchase after April 10, 1979 for the purpose of obtaining rent increases.

"6. Prohibiting the conversion of rental units to condominiums or stock cooperatives without the permission of the Rent Control Board.

"7. Prohibiting the demolition of rental units without permission of the Rent Control Board.

"8. Exempting from controls new construction on vacant land. When demolition occurs it requires that new units be placed under the rent control charter amendment and at least 15 percent of the new units constructed be affordable to persons of low income.

"9. Federal and state income tax benefits are to be considered in evaluating fair return on investment.

"Provisions 6, 7, and 8 are unique to Santa Monica and it is these provisions that make it more difficult for apartment owners to decontrol their investments. In a sense, the charter amendment works to lock in existing land use patterns well into the future and it similarly works to lock in the socio-economic base of the city."

The underlying question in this case is the constitutionality of the Rent Control Ordinance, regulations of the Rent Control Board implementing the ordinance, and the actions of the Board in carrying out the ordinance and regulations. As we shall see in *Birkenfeld* below, a rent control ordinance is not per se unconstitutional or indeed suspect, but must be analyzed to see whether the return which the residential property owners do receive and will receive in the future pursuant to the ordinance satisfy constitutional requirements. If the constitutional requirements appear not to be satisfied in the future, the court should strike down the ordinance as being unconstitutional as the Supreme Court did in *Birkenfeld.*

Rent levels in Santa Monica are set in two ways by the Board:

(a) through the general rent adjustments and

(b) through the individual rent adjustment process. The Board has granted two general adjustments which affect the case at bar, namely a 7% general increase in 1979 and a

6.5% general increase in 1980. These give landlords a 13.5% increase to date over the April 10, 1978 rent levels set by the Rent Control Ordinance and the Board.

On September 18, 1980 the Rent Control Board, which was established under the Rent Control Amendment, adopted what shall be referred to as Regulation 4040, which provides methods and standards for establishing individual rent adjustments. The standards may be summarized as:

1. The landlord's "investment" on which his income is based is computed to be the total of his actual cash invested in the property;

2. Expenses are computed on a cash flow basis, except that expenses for capital expenditures are amortized over the expected life of the item;

3. Landlord's income from the property is computed as the sum of (i) the net cash flow profit; (ii) amount of principal payments of the outstanding debt, if any; (iii) a computation of a so-called "tax benefit" which presumes that the landlord is in the 40% income tax bracket and determines the tax benefit which the landlord purports to receive from taking depreciation on the building as an expense on his state and federal income tax returns; and (iv) the amount of any cash received by the present owner as a result of any refinancing of the property in the past.

4. After the computation of the "investment" and the net return to the landlord, the landlord is entitled to rent levels which will provide him with a rate of return on his "investment" equal to the four-year average yield on AAA corporate bonds for the preceding four years. At present, that average has been computed by the Board to be 8.7 percent.

C. INITIAL CONSTITUTIONAL CONSIDERATIONS

1. The *Birkenfeld* decision

The California Supreme Court case of *Birkenfeld v. City of Berkeley*, 17 Cal.2d 129, 130 Cal Rptr 465, 550 P2d 1001

(1976) is controlling upon the case at bar. *Birkenfeld* holds that rent control in general is a proper exercise of the municipal police power as stated at p.153 as follows:

"We have thus far concluded (1) that in the absence of conflicting or preemptive state law the defendant city's police power within its territorial limits is as broad as the police power exercisable by the Legislature and (2) that general state law does not preclude the defendant city from imposing maximum limits on residential rents within its territory or from restricting the grounds for evicting tenants for the purpose of enforcing those limits insofar as such control of rents and evictions is a proper exercise of the police power."

There need be no showing of an emergency in order to justify such rent control, (*Birkenfeld* at p.157). Although the constitutionality of residential rent controls under the police power depends upon the actual existence of a housing shortage and its ill effects are of sufficient seriousness to make rent control a rational curative measure, the existence of "constitutional facts" upon which the validity of an enactment depends is presumed in the absence of any showing to the contrary. So far, none of the latter pronouncements of *Birkenfeld* are raised as issues in the case at bar.

In considering the provisions of the Berkeley charter amendment the Supreme Court struck down that ordinance as unconstitutional, holding at p.165: "However, if it is apparent from the face of the provisions that their effect will necessarily be to lower rents more than could reasonably be considered to be required for the measure's stated purpose, they are unconstitutionally confiscatory."

2. Controlling principles of constitutional law as to taking of private property for public use

The United States Supreme Court has laid down certain constitutional principles which are applicable in determining the issues of the case at bar.

In *Kaiser Aetna v. United States*, 444 US 164, 62 LEd2d 332, 100 S.Ct 383 (1979), in an action for inverse

condemnation the majority held at p.346: "While the consent of individual officials representing the United States cannot "estop" the United States....., it can lead to the fruition of a number of expectancies embodied in the concept of "property", — that, if sufficiently important, the Government must condemn and pay for before it takes over the management of the land owner's property." At p.343 the court stated that the question of whether governmental action is permissible requires examination of: ".....the economic impact of the regulation, its interference with reasonable investment backed expectations, and the character of the governmental action."

In *Penn Central Transportation Co. v. City of New York*, 438 US 104, 124, 57 LEd2d 631, 98 S.Ct. 2646 (1978) the court stated the standard is whether "....justice and fairness" require that economic injuries caused by public action be compensated by the Government, rather than remain disproportionately concentrated on a few persons."

In *United States v. Causby*, 328 US 256, 90 LEd 1206, 66 S.Ct. 1062 (1946), in an inverse condemnation case the majority held at p.261: "Market value fairly determined is the normal measure of the recovery....And that value may reflect the use to which the land could readily be converted, as well as the existing use." The court held at p.262" "We agree that in those circumstances there would be a taking. Though it would be only an easement of flight which was taken, that easement, if permanent and not merely temporary, normally would be the equivalent of a fee interest. It would be a definite exercise of complete dominion and control over the surface of the land."

As to applicability of the above stated constitutional principles, attorneys for the defendants and interveners argue that such principles are limited to cases in inverse condemnation and that the case in bar does not involve condemnation, that is the taking of private property for public purposes without paying or providing for the payment of just compensation. Defendants and interveners contend *inter*

alia that in order for there to be an inverse condemnation there must be a physical taking of the fee interest or easement in the property. Although the present action does not yet involve an action in inverse condemnation, the contention that there must be a physical taking in order to constitute inverse condemnation is in conflict with the holding of *Agins v. City of Tiburon*, 444 US 1011, 65 L.Ed.2d 106, 100 S.Ct 2138 (1980).

In *Tiburon* the court considered zoning ordinances and held that the ordinances on their face neither prevented the best use of the land nor extinguished a fundamental attribute of ownership and therefore did not take the owners' property without just compensation. However, the court said at p.112: "The application of a general zoning law to particular property effects a taking if the ordinance does not substantially advance legitimate state interests...or denies an owner economically viable use of his land....The determination that governmental action constitutes a taking is, in essence, a determination that the public at large, rather than a single owner, must bear the burden of an exercise of state power in the public interest. Although no precise rule determines when property has been taken...the question necessarily requires a weighing of private and public interests."

The California Supreme Court had earlier held in *Tiburon,* 24 Cal 3d 266, 157 Cal Rptr 372, 598 P2d 25 (1979) that the property owners could not pursue a remedy of inverse condemnation in land use cases but were limited to seeking mandamus or a declaratory judgment. In speaking of judicial remedies in land use cases, the court said at p.275: "We are persuaded by various policy considerations to the view that inverse condemnation is an inappropriate and undesirable remedy in cases in which unconstitutional regulation is alleged." At pp.276-7 the court further stated: "In combination, the need for preserving a degree of freedom in the land use planning function, and the inhibiting financial force which inheres in the inverse condemnation remedy, persuade us that on balance mandamus or declaratory relief rather

than inverse condemnation is the appropriate relief under the circumstances."

3. Are rent control cases subject to the identical constitutional considerations as land use or zoning cases?

As we have seen, a number of the principles which apply to the constitutionality of land use ordinances are adaptable to testing the constitutionality of rent control ordinances. But the two areas are not identical and stricter tests should govern in considering the nature of rent control ordinances. At least two differences are apparent and borne out by the evidence in the case at bar: (a) in a land use situation, the use to which the land may be put is prospective, and the landowner has not yet obtained such "vested" rights as he would in the instance of construction of buildings on vacant land for the purpose of residential income therefrom; (b) in zoning for land use, all segments of the affected population benefit by providing for rationale utilization of that increasingly scarce commodity....useable vacant land; whereas in rent control, although the tenants may benefit, the benefits to the landlord are virtually non-existent.

In *HFH, Ltd. v. Superior Court of Los Angeles,* 15 C3d 508,520, 521 125 Cal Rptr 365, 542 P2d 237 (1973), the Court explained that "...zoning is not an arbitrary action depriving someone of property for the purpose of its use by the public or transfer to another; rather, it involves reciprocal benefits and burdens which the circumstances of this case well illustrate. The shopping center which plaintiffs seem at various times to have contemplated erecting, would derive its value from the existence of residential housing in the surrounding areas. That residential character of the neighborhood, we may assume, results in part from the residential zoning of the area around the tract in question.....[plaintiffs] thus would avoid the enforcement of residential zoning on their property while benefiting from its enforceability as to other property."

4. Is the "return on historical investment" standard, which is sometimes used as the constitutional measure for

determining the constitutionality of public utility regulation, the test to be used in determining the rate of return to which residential property owners are entitled? I conclude that "return on historical investment" is not the proper standard for residential income property.

The Rent Control Ordinance and its implementing Regulation 4040 allegedly are founded upon the theory that the property owners are entitled to no more return than that which is calculated upon the historical investment of each particular landlord measured at the time the landlord acquired his property. But *Birkenfeld* teaches at p. 165 that "The provisions are within the police power if they are reasonably calculated to eliminate excessive rents and at the same time *provide landlords with a just and reasonable return on their property.*" (emphasis added.)

In *Troy Hills Village v. Township Council etc.*, 68 NJ 604 350 A2d 34 (1975) the court held at pp. 42-43: "Although the subsidization of housing may be deemed a desirable or necessary response to social or economic ills, landlords cannot be compelled by municipal ordinances to subsidize the housing needs of their tenants. The legislative power to set rates does not give a municipality the 'power to compel the doing of the services without reward.....' "

"We perceive that deciding whether a rent regulation permits just and reasonable return requires consideration of the value of the rental property, the reasonable expense of operating the property, the income, the rate of return on the value of the property actually permitted by the rent regulations and the minimum rate of return which would be just and reasonable for that property. Basically, this procedure involves two separate states of calculations. First, the tribunal must make a factual finding as to the rate of return on the value of the property which the landlord will in fact receive under the rent leveling ordinance. Second, the tribunal must make a factual determination as to that rate of return below which an actual rate of return would be confiscatory. This second determination can be designated

as the 'just and reasonable' rate of return on the value of a given rental unit. If the rate of return which the landlord actually receives falls below the just and reasonable rate, then the ordinance must be invalidated as confiscatory." See also, *Helmsley v. Borough of Fort Lee*, 78 NJ 200, 394 A2d 65 (1978) holding a rent control ordinance unconstitutional as being confiscatory.

We take judicial notice of two Superior Court cases in Los Angeles County. In *Milosavljevic v. The Santa Monica Permanent Rent Control Board*, No. C305 309, filed Sept. 12, 1980, Judge Vernon G. Foster, in considering the instant Rent Control Amendment, ordered the Rent Control Board to make a finding on, among other things: "The reasonable fair value of Petitioner's property," and "The amount of rental income required to give Petitioner a just and reasonable return on the value of his property." In *Castiglione v. Santa Monica Permanent Rent Control Board*, No. C319 910 on November 3, 1980, Judge Thomas T. Johnson granted a writ of mandate against the Rent Control Board concerning the instant ordinance, and adjudged: "Granted in that matter is remanded for a full evidentiary hearing, where owners are to be allowed to present all relevant evidence as to 'a just and reasonable return on their property'. (per Birkenfeld vs. City of Berkeley, 17 C3d 129). 'Property' is not necessarily 'investment', and respondent cannot arbitrarily and unreasonably limit evidence to be considered by it through the use of definitions in regulations."

****

"While rents may be rolled back to a given date, this does not necessarily create a valid presumption that rents on that date report a fair return on the property."

There are a number of differences between regulation of a public utility and regulation of residential income property. These include the following:

(a) a public utility's equitable owners, namely the shareholders of the corporation, purposely devote the

property for use as a public utility with the expectation that they will receive compensation in the form of regulated rates to the consumers;

(b) the equitable owners are benefited since the utility is regulated not only that it may charge no more than the regulated rate, but the consumers (having a positive need for such monopolized services) may not pay less than the regulated rate; thus the utility is receiving a guaranteed price for its services in a monopolistic situation in which the consumers are literally forced to deal with the utility;

(c) if the utility is unable to receive a fair return from its property, it is entitled to withdraw its property from the regulated market. *Lyon & Hoag v. Railroad Commission of California,* 183 Cal. 145 190 P. 175 (1920) and *Brooks-Scanlon Co. v. Railroad Commission,* 251 US 396 64 LEd. 323, 40 S.Ct. 183 (1920) Under the Rent Control Amendment, the landlords are virtually unable to remove their units from the rental market;

(d) as the evidence shows, a public utility usually keeps its equipment up to date by renovation and acquiring new equipment, so that "historical cost" relates to not only the original time of acquisition or construction but to a continuous series of events to which successive "historic investment" valuations are applied;

(e) because of the continued increase in property values during the past century, although sales of entire utilities are indeed few in number, they should be able to realize more than "historic investment" upon such sales. Also see *State of Missouri v. Public Service Comm'n, 262 US 276, (1923)* namely Justice Brandeis dissent at pp. 290-291 and at 310.

Under California law, public utilities are entitled to a return based on the value of the property at a time when it is first devoted to public use. *Southern California Edison Co. v. Public Utilities Commission*, 20 C3d 813, 818, 144 C.Rpt. 905 570 P2d 945 (1978); *Miller v. Railroad Commission,* 9 C2d 190, 202, 70 P2d 164, 112 ALR 221

(1937); *Application of Pacific Gas & Electric Co.*, 74 Opinions and orders of the Public Utilities Commission of California 487 (Decision No. 80878) December 19, 1972, in which the Commission held that the valuation of a storage facility should be as of the time it was devoted to public use rather than its book value. The Commission stated at 502: "The Uniform System of Accounts for National Gas Companies, in its instructions for setting gas plant cost, provides that original cost be determined *as of the time of the property's first devotion* to utility service". (emphasis added).

In the case of the landlords in Santa Monica, their properties were not devoted to public use until at least April 10, 1979. Hence assuming *arguendo* that the residential property owners are to be treated as if they were a public utility, the property of each would be entitled to a return based on the fair market value of the property as of April 10, 1979.

§810 of the California Evidence Code states: "This article provides special rules of evidence applicable only to eminent domain and inverse condemnation proceedings." Although the present action is not one in inverse condemnation, nevertheless because of a close analogy to inverse condemnation actions, see *Tiburon supra*, the same evidentiary standards and limitations are persuasive. §811 states: "As used in this article, 'value of property' means market value of.....(a) Real property or any interest therein....." Thus Division 7, Chapter 1, Article 2 of the California Evidence Code allows the following modes of establishing such market value of real property: (a) sales of subject property, §815; (b) comparable sales, §816; (c) leases of subject property, §817; (d) comparable leases, §818; (e) capitalization of income, §819; and (f) reproduction cost, §820. Historical investment is not set forth as one of the permissible bases upon which expert testimony may be based.

Although the "historical investment" standard may be proper as one method for testing the constitutionality of rates of return upon public utilities, I hold that it is constitutionally

impermissible as the basic standard to be used in testing the constitutionality of returns upon residential income property. Among other reasons for this holding is that residential income property is a form of investment fundamentally different than investment in public utility stocks. Public utility stocks, as the evidence shows, are purchased mainly for current income, with capital growth being quite a secondary consideration. On the contrary, residential income property, as the evidence shows, is purchased in our present era with capital growth being the major consideration. In these days of high inflation rates and high interest rates, residential income property is desirable as a hedge against inflation.

5. Is the term "investment" as used in the Rent Control Amendment equivalent to the term "property" as used in the Fifth Amendment's guarantee that private property will not be taken for public use without just compensation?

In some cases involving public utilities the California courts have used the phrase "'return on investment" as an equivalent to the phrase "return on property. In *Southern California Gas Co. v. Public Utilities Commission*, 23 C3d 470,153 CRpt. 10, 591 P2d 34 (1979), the court held at p. 474 that the rates must guarantee the public utility"... a fair return on its *investment* which is found by multiplying its authorized rate of return by the *value of property devoted to public use...*" (emphasis added).

6. If part of the Rent Control Amendment were to be held unconstitutional and the remainder held constitutional, may the latter portion be regarded as valid being severable?

Where only certain parts of a statute are unconstitutional the constitutionality of the remainder depends whether the enacting body intended it to be severable. If so, the unconstitutional portions will be held as void, and the unoffending portions allowed to remain as valid, under the doctrine of severability. *People v. McCaughan*, 49 C2d 409, 416, 317 P2d 974 (1957). Section 1812 of the Rent Control Amendment provides: "If any provision of this Article or

application thereof to any person or circumstances is held invalid, this invalidity shall not affect other provisions or applications of this Article which can be given effect without the invalid provision or application, and to this end the provisions of this Article are declared to be severable. This Article shall be liberally construed to achieve the purposes of this Article and to preserve its validity." Such language has been considered favorable as a model severability clause. See 5 *Summary of California Law,* Witkin (8th ed.) *Constitutional Law* §66. All parties to this action urge that the ordinance is severable.

7. Are property owners entitled, constitutionally, to withdraw from the regulated market?

Even a public utility is entitled to withdraw its property from the regulated market if it is unable to receive a fair return from its property. See *Lyon & Hoag* and *Brooks-Scanlon supra.*

The same constitutional protection is afforded to a property owner which is not a public utility. In *Bowles v. Willingham,* 321 US 503, 517 88 L.Ed. 892, 64 S.Ct. 641, the Supreme Court held that wartime rent controls were mitigated by the provision that "...'nothing in this Act shall be construed to require any person to sell any commodity or to offer any accommodation for rent.' There is no requirement that the apartments in question be used for purposes which bring them under the Act." Also in *Permian Basin Area Rate Cases,* 390 US 747, 772 20 L.Ed. 2d 312, 88 S.Ct. 1344 (1968) the court stated:

"....it is pertinent that the Commission may supplement its provisions for special relief by permitting abandonment of unprofitable activities.

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"...certain of this Court's decisions might be understood to have suggested, that if maximum rents are jointly determined for a group or area, the members of the regulated class must, under the constitution, be proffered opportunities

either to withdraw from the regulated activity or seek special relief from the group rate."

8. What is the definition of a "just and reasonable" return upon property?

Since a property owner, the use of whose property is regulated, is entitled to a "just and reasonable" return upon his property under constitutional standards, what is the definition of the phrase "just and reasonable?" *Federal Power Commission v. Hope Natural Gas Co.*, 88 L.Ed. 333, 64 S.Ct. 281 (1944) states that owners are entitled to a "just and reasonable" return which "... should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." That was a definition tailored to fit public utilities. As for commercial non-public utility property the New York Court of Appeals gives us guidance in *Penn Central v. City of New York*,42 NY2d 324, 397 NYs2d 914,918,366 NE2d 1271, 1275 (1977) aff'd in 438 US 104 57 LEd2d 631, 98 S.Ct. 2646 (1978):

"Even when regluation is designed to achieve such an acceptable purpose, however, the landowner must be allowed a reasonable return or equivalent private use of his property...That is, in the case of commercial property, the owner must be assured of a continued reasonable return on the property." In addition, the New York Court of Appeals held that "...the reasonableness of the return must be based on the value of the property...."

9. Must plaintiffs show the unconstitutionality of the Rent Control Amendment by "clear and convincing evidence?"

Defendants and interveners urge that plaintiffs must show the unconstitutionality of the Rent Control Amendment by "clear and convincing evidence." Section 115 of the California Evidence Code provides that: "Except as otherwise provided by law, the burden of proof requires proof by a preponderance of the evidence." Thus in *Liodas v. Sahadi*, 19 C3d 278, 291

137 CRpt. 635, 562 P2d 316 (1977) the California Supreme Court rejected the use of the "clear and convincing" standard in actions involving a claim of fraud, thus overturning what had long been thought to be the test in fraud cases.

There do not appear to be any California cases to support defendants' contention, and we submit that the reason for this is that what is cast as a rule of evidence should be cast by defendants and interveners as a legal proposition, as follows. A legislative act is presumed to be constitutional. Unconstitutionality must be clearly shown and doubts will be resolved in favor of its validity. *Alabama State Federation v. McAdory,* 325 US 450, 89 LEd 1725, 1737, 65 SCt 1384, 1394 (1945). A statute susceptible of two interpretations will, if possible, be construed as constitutional. *Palermo v. Stockton Theatres,* 32 C2d, 53,60, 195 P2d 1 (1948).

In the case at bar the evidence necessary to support the court's intended decision is clear and convincing; and in most instances there is little controversy about the essential facts, only the conclusions to be drawn from those facts. Hence whether the test be "clear and convincing" or by a "preponderance" has no significance under this testimony and documentary evidence.

D. SUMMARY OF RELEVANT EVIDENCE

Not all of the evidence is summarized here but only such portions as are essential to consideration of the constitutional issues.

The evidence as presented by all sides is that the average rate of return upon owners' equity, as of April 10, 1978, (which is the rollback date for establishing the base rents), was between 1 and 2 percent. If the historical cash investment is used as the standard (as may be imposed by one interpretation of the Rent Control Amendment, and is certainly imposed by Regulation 4040) defendants' evidence shows that the average April 10, 1978 rate of return on the owners' investment was between 2 and 4 percent. The evidence shows that the reason that rents were at these low levels

is because investors looked to appreciation and future income for the major portion of their returns. This is comparable to differences in return on investments in the stock market where some investors buy utility stocks yielding a seemingly satisfactory present return with some although a minor prospect of future appreciation, whereas other investors may buy "growth" stocks yielding little if any present returns with the hope of capital appreciation.

Professor Kinnard, an expert witness for plaintiffs, testified that in a rental environment such as now faces Santa Monica landlords, namely a situation where rents are under control, where the properties may not be converted to other uses freely, along with the other limitations in the rent control structure, that the appropriate "rock bottom" rate of return to landlords from rentals should be 13.25%. The basis for this is that such would be the average return realized by larger insurance companies in comparable investments of residential income properties.

Professor Kinnard further testified that the historical investment approach is not a proper method of valuation for residential income property, by good appraisal standards. An investor's original expectation, which is reflected by what he originally was willing to pay for a property, is irrelevant to current valuation. The past is irrelevant because it is the present market which sets valuation.

Plaintiff's expert witness Mr. Foreman testified that there was significant appreciation before the rent control law was passed; that appreciation has halted, although no significant depreciation was observed; and that the average return on equity received from rental income alone of April 10, 1978 was 1.63 percent.

Mr. Foreman had made an elaborate study based upon reported sales of Santa Monica residential income properties for a number of years prior to the Rent Control Amendment, as well as the three quarters after the imposition of rent control. The method used was to use the statistical tool of

multiple regression, comparing trends in Santa Monica and in the control area of Torrance-Redondo for the periods of time measured. Defendants attack the statistical and mathematical methods used by Mr. Foreman, although they did not offer comparable evidence of their own of any similar study, except for the study of Professor Shulman. As noted above, the differences between the testimony of plaintiffs' expert witnesses and those of defendants is not that much different as to affect the results of this case, as stated above.

Defendant's expert witness, Professor Shulman, testified that according to his data some sales in Santa Monica occurring after the imposition of rent controls denoted an increase in gross rents. He found that to be extraordinary because in general sales prices, in terms of gross rents, usually declines after a community imposes rent controls. He noted an important caveat that all of the 1980 transactions were accomplished with owner financing while only a portion of the pre-1978 transactions were financed in this manner. He explained that the only rational basis for explaining this increase in gross rent multipliers in Santa Monica would be a belief on the part of purchasers that controls would be lifted sometime in the future.....that is speculation that somehow rent controls would be eliminated by the voters, or by court decision, holding that the Rent Control Amendment was in whole or in part unconstitutional.

Professor Shulman stated another reason for the failure for gross rent multipliers to decline in Santa Monica is that the land value there is equal to or greater than the land and the rent controlled building put together. If an apartment unit is today worth say between $40,000-40,000 a unit, so is the underlying land if a demolition permit can be granted without restrictions. Under the Rent Control Amendment properties cannot be freely demolished or converted. He stated that although nominal gross rent multipliers did not decline, the real value of apartment units did decline. (see Tables 3 and 4 and p. 17 of Exhibit 226).

I ruled that it is impermissible in considering fair market values in the case at bar to permit the intrusion of speculation that this or any other court may hold the Rent Control Amendment in part or as a whole to be unconstitutional. This is similar to the prohibition in eminent domain cases forbidding consideration of enhancement in land values brought about in anticipation of a proposed improvement which is the cause for initiating the eminent domain proceedings in the first place. In 4 Nichols *Law of Eminent Domain* (3rd ed.) §12.3151 the rule is stated as follows: "The general rule is that any enhancement in value which is brought about in anticipation and by reason of a proposed improvement is to be excluded in determining the market value of such land...." *City of San Diego v. Boggelin,* 164 CA2d 1, 330 P2d 74 (1958).

Professor Shulman termed the Rent Control Amendment as "....the most sweeping and stringent second generation rent control law in the Untied States." (Exhibit 226, P. 1). His calculations show that the Rent Control Amendment "...yields a capitalized loss between $335 and $648 million..." to the landlords (Exhibit 226, p. 15). He states that although nominal gross rent multipliers did not decline, the real values of apartment units did decline. (Exhibit 226, p. 17). He concludes that "landlords suffered substantial losses in potential income and real wealth as a result of the controls."

In addition to the two general rent increases, landlords are permitted to seek individual increases. Testimony was given that it takes an average of 80 hours for a landlord to prepare such petition for rent increas. A sample result of employing Rule 4040 was testified to by Ms. Lieberman (Exhibit 24D), in which a return of $293.45 would be allowed on a landlord's hypothetical $200,000 building. The individual rent increases in evidence do not seem to show sufficient individual increases to make the results non-confiscatory in their ultimate effect.

The court takes judicial notice of the sample rent increase decisions offered by plaintiffs. In answer to defendants'

contention that plaintiffs' sample decisions were not typical, defendants have not accepted the Court's invitation to introduce other decisions that would show different conclusions. In the absence of defendants proferring other sample decisions, the Court concludes that plaintiffs' examples are typical of the actions of the Rent Control Board.

The City of Santa Monica is surrounded on three sides by the City of Los Angeles and on the fourth side by the Pacific Ocean. The City of Los Angeles has rent control ordinances which are much less stringent than that of Santa Monica. It was estimated that there have been perhaps no more than 35 or so individual petitions for rent increases filed in the City of Los Angeles, which is indeed but a handful. One conclusion from this is that the City of Los Angeles system of rent control is much less stringent than that of Santa Monica and perhaps is not regarded as consfiscatory by the landlord group. The fact that Santa Monica's rent control system may be the most stringent in the nation and is far tighter than that of the City of Los Angeles which virtually surrounds Santa Monica does not indeed render the Rent Control Amendment confiscatory and hence unconstitutional. But it does entitle us to scrutinize closely the Rent Control Amendment in its operational effect to test its constitutionality.

E. CONCLUSIONS ON CONSTITUTIONAL ISSUES

1. In General

Applying the evidence in the case to the applicable constitutional principles as stated below, I hold that the effect of portions of the Rent Contol Amendment, Regulation 4040 and the operation of the Rent Control Board is to produce either now or in the immediate future a confiscatory result upon the average efficient class of landlords operating residential income property in the City of Santa Monica. Since this is not a case in inverse condemnation, it is not necessary for me to hold that confiscation has actually taken place. I read *Tiburon* as placing an obligation upon a court

of equity to prevent a confiscatory effect of an ordinance by means of declaratory relief, mandamus, or other appropriate remedy before there has actually taken place a "taking" of real property. Hence *Tiburon* encourages this court to take action before there has been a "taking" in order to prevent the imposition upon the taxpayers of Santa Monica of a liability in a huge sum for compensation to the landlords for any future "taking" of property. The court of equity is encouraged to prevent such future result before it occurs in order to balance the competing interests. Hence in examining the Rent Control Amendment, Regulation 4040, and the actions of the Rent Control Board I do so with at least three principal goals: (a) to produce a result which is non-confiscatory to the landlords; (b) which will prevent a result of an actual "taking" of real property; and (c) to preserve so much of the existing Rent Control Amendment which can be salvaged, as to carry through the wishes of the majority of Santa Monica voters.

Although issue of the necessity of rent control for the City of Santa Monica is not an issue in this case by virtue of the pretrial stipulation and order (see *Birkenfeld*) this court is mindful of the hardship that affects renters in Santa Monica since the increase of rents in the 1970's. However, Dr. Peter Marcuse, expert witness for defendants, testified that rent controls alone would not solve the problems of the middle class and lower middle class renters in Santa Monica or elsewhere in the United States where there may be housing shortages.

The following constitutional provisions have been breached. As for the federal constitution the principal defect of the effect of the ordinance as implemented is to abridge the Fifth Amendment which states: ".....nor shall private property be taken for public use, without just compensation."

There need be no actual physical invasion of real property for there to occur a "taking" in the 5th Amendment sense of the word. See *Birkenfeld* at p. 165. In *Penn Central Transportation v. City of New York*, 438 US 104 57 L.ed

2d 631, 98 S.Ct. 2646 122 n. 25 (1978), the court stated: "As is implicit in our opinion, we do not embrace the proposing that a "taking" can never occur unless government has transferred physical control over a portion of a parcel."

The 14th amendment is infringed in denying equal protection of the laws. Under the rent control system as applied a landlord who purchases Whiteacre for $200,000. in 1977 will be allowed a much higher amount of rent than one who purchases Greenacre (a virtually similar piece of improved property) in 1970 for say $50,000. Someone who inherited Blueacre (a virtually similar piece of improved property) in 1973 may receive less permissible rents than either the owners of Whiteacre or Greenacre because there is little "investment" in Blueacre other than the amount of death duties paid as a result of the inheritance. Such differentiation between owners of virtually identical properties is constitutionally impermissible.

The following provisions of the California Constitution have been infringed:

(a) Art.1, Sec. 1, providing: "All people....have certain certain inalienable rights among which are those of ....acquiring, possessing, and protecting property...";

(b) Art.1, Sec. 11: "All laws of a general nature shall have a uniform operation."

(c) Art. 1, Sec. 14: "Private property shall not be taken or damaged for public use without just compensation...";

(d) Art. 1, Sec. 21: "....nor shall any citizen, or class of citizens be granted privileges or immunities which, upon the same terms, shall not be granted to all citizens."

(e) Art. 11, §9: "Any...city...may make and enforce within its limits all such local, police, sanitary and other regulations as are not in conflict with general laws."

If the 14th amendment due process clause and the similar provision in the California Constitution, Art. 1, Sec. 13, be considered in a procedural rather than a substantive sense, it can also be said that the due process clause has been infringed by the operation of the Rent Control Amendment.

The fact that rents were rolled back one year to April 10, 1978, in which the market was assumed to be in equilibrium, is constitutionally permissible provided adjustments are made to allow for the effects of inflation to April 10, 1979. Hence §1804(b) is constitutional.

2. The Rent Control Ordinance

In considering the Rent Control Amendment, I hold as unconstitutional only those portions which produce or will produce a confiscatory effect, preserving all other portions not necessary to be stricken.

a. Section 1805. Individual and General Adjustments of Ceilings of Allowable Rents

(1) Sub-Paragraph (b)

Such provisions for general annual increases insofar as the wording goes are constitutional. The effect of such two general increases is or will lead to confiscatory results as being too low. The two increases totalling 13.5% since the effective date of April 10, 1978 are less than that required to produce a non-confiscatory result. What is the lower borderline of the zone between that which is "confiscatory" or that which is"non-confiscatory?" Plaintiffs have produced evidence that the lower borderline is that point which will yield a return to the average efficient group of landlords of 13.25% per annum. There is also evidence (Exhibit 11-1) that the Consumer Price Index rose from a figure on all items of 195.4 in 1978 to 217.4 in 1979, and thence to 249.4 in August 1980.

At this time, I do not rule that landlords must receive an increase in rents sufficient to yield 13.25% per annum; nor do I rule that the amount of general annual increase in rents must be equal to the percentage increase in Consumer Price Index. We do not have sufficient evidence in the record at this time upon which to base any definitive ruling as to the minimum amount of general increase which is constitutionally required. That issues is reserved until a later time at a later bifurcated hearing at which time the court will

have considered new regulations, as will be discussed hereafter. In view of the high inflationary rate and large increase in interest rates during the past several years, any such question is indeed complex.

(3) Sub-Paragraph (e)

(a) That portion of the next to the last sentence reading "...the speculative nature of the investment, whether or not the property was acquired or is held as a long term or short term investment.....is held to be unconstitutional and must be stricken if the ordinance as a whole is to be sustained. I further find that such stated portion is severable from the ordinance as a whole.

(b) That portion of the next to the last sentence reading "...and the landlords rate of return on investment." and the final sentence reading: "It is the intent of this Article that upward adjustments in rent be made only when demonstrated necessary to the landlord making a fair return on investment" may each be construed as constitutional if the phrase "return on investment" in each instance is equated to mean "return on property." "Return on property" I take to mean the "return on fair market value of the property." This construction is in accordance with the California cases cited for this proposition above, and is done so as to construe as much of the ordinance as can be done as constitutional.

(4) Sub-Paragraphs (f) and (g) I find to be unconstitutional.

b. Section 1804. Maximum Allowable Rents

Sub-Paragraph (t) may be unconstitutional as it sets forth four requirements which the Board must find before it can permit a landlord to remove a controlled rental unit from the housing market by demolition, conversion or other means. The only requirement that probably can be imposed is a finding that the landlord cannot make a fair return on investment by retaining the controlled rental unit, which appears to be the law even in the area of public utilities. The City Attorney urges that there are other ordinances in

existence, which are not before this court, that also would restrict removal of controlled rental units from the rental market even if Sub-Paragraph (t) were declared unconstitutional. A court of equity should not do an idle act, and therefore I may be accomplishing no useful purpose at this time to declare Sub-Paragraph (t) unconstitutional. Moreover, when the Board comes up with a new regulation and general increase that meets constitutional standards it may render it unnecessary at such time to consider the constitutionality of Sub-Paragraph (t) because the class of efficient landlords may then be entitled to receive a non-confiscatory rate of return. In any event the issue of constitutionality of Sub-Paragraph (t) is bifurcated to a later time.

c. The other provisions of the Rent Control Amendment do not appear to be necessarily unconstitutional on their face or as to their effect as of this time.

4. Regulation 4040

Regulation 4040 is unconstitutional on its face and in its effect, in a number of instances. Because the provisions thereof are intertwined, I find it impossible to sever those portions which may be constitutional. In any event, the Rent Control Board and the City Council should have the opportunity to fashion a new regulation that may meet constitutional standards.

5. The Operation of the Board in Rendering Decisions

Since the Board must fashion a new regulation, it is unnecessary to consider actual operations in the past. The test will be how the Board functions under a new constitutional regulation.

F. CONCLUSIONS ON ISSUES FOR TRIAL

(NOTE: numbering corresponds to that set forth in the Pretrial Statement and Order).

a. "Whether the Rent Control Amendment, either on its face or as interpreted or applied by the Rent Control Board, allows landlords generally....a just and reasonable return..."

(1) Landlords are constitutionally entitled to a just and reasonable return on their "property" rather than a return on their "investment", if "investment" is taken to mean"historic investment". I find under California law as stated above that the word "property" may be equated to the word "investment", and that "property" is to be valued at its "fair market value."

(2) "Whether the procedures set forth in the Rent Control Amendment and/or adopted by the Rent Control Board properly define net rental income from rental property..." The answer is in the negative, as set forth above.

(3) "Whether the Rent Control Amendment, either on its face or as interpreted or applied by the Rent Control Board, allows landlords a rate of return that is just and reasonable." I find in the negative, as set forth above.

(4) "Whether the presumption...that the net rental income on April 10, 1978, provided landlords with a just and reasonable return is either factually justified or legally appropriate;" I find that it is permissible to roll back rents to April 10, 1978, and to assume that the free market had set rents as of April 10, 1978 in the then uncontrolled state of the market. As set forth above, I find that net rental income as of April 10, 1978 failed to provide landlords with a just and reasonable return if anticipated appreciation be excluded. The reason is that landlords expected appreciation to be the larger share of total realization from rental property.

(5) It is not necessary to determine at this time whether the rent adjustment procedures afford owners of rental property prompt and effective relief, and such issue is bifurcated until a later time.

(6) It is not necessary to determine at this time whether the rent adjustment procedures discourage, inhibit or delay

meritorious petitions for individual rent increases, and such issue is bifurcated until a later time.

(7) As stated above the Rent Control Amendment on its face and as interpreted and applied by the Rent Control Board deprives landlords of equal protection of the laws.

(8) It is not necessary at this time to determine whether or not the Rent Control Amendment, either on its face or as interpreted or applied by the Rent Control Board, deprives landlords of due process of law (in a procedural sense), and this issue is bifurcated until a later time.

(9) As to tax matters:

(a) It is not necessary at this time to consider whether the Rent Control Board may consider the tax benefits of claiming depreciation as a deduction on the landlord's tax returns, and this issue is bifurcated until a later time.

(b) As to the Board requiring tax return information, as of this time I do not find this to be violative of law; and

(c) (d) As to the Board's presuming of tax benefits or considering such presumed or actual tax benefits, it is not necessary to consider at this time such issues, and hence these issues are bifurcated until a later time.

(10) It is not necessary at this time to determine whether the Rent Control Amendment on its face or as interpreted or applied by the Board unconstitutionally diminishes the value of rental property (as this applies to right of removal of units from the rental market), and hence this issue is bifurcated until a later time.

(11) It is not necessary at this time to determine whether the Rent Control Amendment either on its face, or as interpreted or applied by the Board may prohibit the removal of rental units from the rental housing market, and hence this issue is bifucated until a later time.

(12) It is not necessary at this time to determine whether the Rent Control Amendment on its face, or as interpreted

or applied by the Board imposes an unreasonable restraint on alienation, and hence this issue is bifurcated until a later time.

b. "Whether registration fees paid.....are taxes.....in violation of Article XIII A of the California Constitution."

Such registration fees are not special taxes to raise revenue but are designed for the purpose of paying the regulatory expenses necessarily incurred in connection with the Rent Control Act. Hence such fees are not violative of the California Constitution.

G. IMPLEMENTATION OF INTENDED DECISION OF COURT

The Acting City Attorney of Santa Monica has requested that if the court should find that part of the Rent Control Amendment or regulations is unconstitutional that the Rent Control Board and the City Attorney be given a ninety day period to come up with a new plan or regulations that may satisfy the constitutional infirmities of the Rent Control Amendment and its regulations. Accordingly, the Rent Control Board and the City Attorney are granted a period of ninety days to present a new plan or regulations to meet the constitutional infirmities set forth in this memorandum of intended decision. Such plan or regulations shall be filed with the court, after service upon other parties, no later than June 1, 1981.

H. CHOICE OF REMEDIES

TIBURON at pp. 272-277 holds that the appropriate remedies in an inverse condemnation case are declaratory relief or adminstrative mandamus. The present action is not one in inverse condemnation nor does it seek administrative mandamus, but the analogy is close. There is sound authority that a mandatory injunction should also lie in lieu of mandamus. See 5 Witkin *California Procedure* 2d "Extraordinary Writs" §19, and 3 Davis *Administrative Law Treatise* §§23.09-23.12 and 1970 Supplement. The present action seeks

a mandatory injunction and declaratory relief, either of which should be an appropriate remedy. Since the instant memorandum of intended decision is an interim one in this bifurcated case, it is not yet necessary to determine the precise remedies to be employed.

I. ORDER OF BIFURCATION

Pursuant to applicable statute and Rules of Court, all issues not determined as set forth in this memorandum of intended decision are hereby ordered to be bifurcated; and hearing thereon shall be set at a later time as may be determined by the court.

DATED:
March 6, 1981

Richard A Lavine

Judge of the Superior Court
Richard A. Lavine

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SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

JAMES W. BAKER, et al., Plaintiffs, v. CITY OF SANTA MONICA, et al., Defendants.	CASE NO. WEC 058763 (Transferred to South Central District)
SANTA MONICANS FOR RENTERS' RIGHTS, et al., Interveners.	PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW (REVISED)
JOHN J. STEIN, et al., Plaintiffs, v. CITY OF SANTA MONICA, Defendants.	CASE NO. WEC 059251 (Transferred to South Central District)

APPENDIX-E

SANTA MONICANS FOR RENTERS' RIGHTS, et al.,

Interveners.

The above-entitled case was transferred to the South Central District and came on regularly for trial on December 1, 1980, in Department C of the above-entitled Court, South Central District, the Honorable Richard A. Lavine, Judge, presiding, without a jury, and was tried on December 1, 1980 through December 15, 1980, inclusive. Plaintiffs, and each of them, appearing by Latham & Watkins by Stephen L. Jones and George Kimball, Defendant City of Santa Monica and its City Council persons appearing by Stephen Shane Stark, City Attorney, Defendant Santa Monica Rent Control Board and its Commissioners, appearing by David Pettit, and Interveners Santa Monicans for Renters' Rights and Santa Monica Fair Housing Alliance appearing by Legal Aid Foundation of Los Angeles by Robert M. Myers.

The Court, having heard and considered the evidence, both oral and documentary, introduced on behalf of counsel, and being fully advised, makes the following Findings of Fact and Conclusions of Law. Pursuant to Rule 232.5, California Rules of Court, these Findings of Fact and Conclusions of Law are limited to issues not bifurcated by the Court's Memorandum of Intended Decision. All issues not decided by the Court's Memorandum of Intended Decision are reserved for further proceedings.

PROPOSED FINDINGS OF FACT

The Court makes the following findings of fact:

1. Plaintiffs, and each of them, at all relevant times herein were residents of the City of Santa Monica; owned residential rental property therein; paid taxes to the City of Santa Monica within the year preceding the filing of this action; and have paid rent control registration fees to defendant Santa Monica Rent Control Board (the "Board) for registration of their controlled residential rental properties.

2. On April 20, 1979, a majority (but less than two-thirds) of the electorate voting in Santa Monica voted in favor of Article XVIII of the Santa Monica City Charter (the "Rent Control Amendment"), attached as Exhibit A hereto and incorporated herein by this reference. Said Amendment, by its terms, applies to all residential rental properties located within the City of Santa Monica except those expressly exempted in Section 1801(c) therein. Residential rental properties subject to the Rent Control Amendment shall be referred to herein as controlled rental properties.

3. Defendant Rent Control Board is a public agency established by the Rent Control Amendment to administer said Amendment.

4. Defendant City of Santa Monica is a California Charter City.

5. Defendants William Allen, Gerald Goldman, Dolores Press, Neil Stone, and Roberta Raiford are Commissioners of Defendant Rent Control Board.

6. Defendants Christine Reed, William Jennings, Ruth Yanatta Goldway, Cheryl Rhoden, Perry Scott and John Bambick are each members of the City Council of the City of Santa Monica.

7. Upon its adoption, the Rent Control Amendment froze all rents on controlled rental units and, 120 days thereafter, reduced said rents to levels in effect on April 10, 1978. The so-called rollback levels, together with any allowed general or individual rent adjustments, became the maximum allowable rents under the Rent Control Amendment. In part, the Rent Control Amendment establishes procedures for general and individual rent adjustments, prohibits removal of controlled rental units by demolition, conversion or otherwise, except upon Board approval under Section 1803(t), and forbids rent increases to offset increases in debt service on properties purchased or refinanced after enactment of Rent Control on April 10, 1979.

8. There now exists a controversy between Plaintiff and Defendants, and each of them, regarding Plaintiffs' rights, duties and responsibilities under the Rent Control Amendment and under the Board's interpretation and implementation of the Amendment.

9. On September 18, 1980, the Board promulgated a regulation (Regulation 4040) setting forth methods and standards for general and individual rent adjustments. A copy of this Regulation is attached as Exhibit B hereto and incorporated herein by this reference. Regulation 4040 embodies, in part, standards evolved and articulated by the Board in decisions issued before that date, including the decisions offered in evidence at trial. Included in Regulation 4040 is a presumption that April 10, 1978, rents assured the landlord a fair return. In order for an owner to receive an individual rent increase which would allow a net return on his equity as of April 10, 1979 above that received on April 10, 1978, he must rebut the aforementioned presumption. If he successfully rebuts the presumption, he may receive rent increases calculated to yield a "return on investment" (as defined in Regulation 4040 equal to the four-year average yield on AAA corporate bonds for the preceding four years, calculated by the Board as 8.7 percent for 1975-79).

10. The decisions by the Rent Control Board submitted by Plaintiffs herein are reasonably representative of all decisions on individual rent adjustments rendered by the Rent Control Board.

11. Regulation 4040, both on its face and in its application, does not understate the landlords' net income.

12. Even if a landlord rebuts the presumption that his April 10, 1978 rents provided him a just and reasonable return, Regulation 4040 fails to allow the average efficient such landlord a just and reasonable return on his property.

13. The average, sophisticated rental owner requires approximately 80 hours to complete a petition for rent increase for filing with the Board.

14. The average time for the Board to act on a petition for rent increase, from the day of its filing to the date of Board decision on appeal is 117 days. When no appeal is taken to the full Board, the average time for decision is 72 days.

15. The expectations of owners of residential rental properties at the time of their original purchase of their properties and their "investment" (as that term is defined by Regulation 4040 and applied by the Board. The definition of "investment" as set forth in Regulation 4040 and applied by the Board shall hereinafter be referred to as "historic cash investment") are irrelevant to a determination of the value of said property. Historic cash investment is not a just and equitable basis or method for valuation of interests in residential rental property.

16. Use of the historic cash investment standard results in widely divergent rents for identical properties depending upon, in part, the original method and means of acquisition and financing of the property by the owner of the property on April 10, 1979.

17. There is no reasonable purpose to be served by the Rent Control Amendment for discriminating between similar properties on the basis of factors personal to the particular person who owned the property on April 10, 1979, including his cash investment, his particular terms of financing and his tax bracket.

18. On April 10, 1978, rates of return from rental income on Santa Monica residential rental properties averaged (a) between 1 and 2 percent based upon the owners' equity (*i.e.*, the current value of the property less the outstanding indebtedness); and (b) between 2 and 4 percent on the basis of the owners' historic cash investment.

19. Before enactment of the Santa Monica Rent Control Amendment on April 10, 1979, owners of Santa Monica residential rental properties reasonably expected the majority

of their returns from their properties in the form of appreciation of said properties.

20. For at least ten years prior to April 10, 1979, the value of the average residential rental property and of the average residential non-rental property in Santa Monica increased substantially.

21. After April 10, 1979, there has been no appreciation of Santa Monica controlled rental properties. This halting of appreciation has been primarily due to the enactment of the Rent Control Amendment and the provisions thereof.

22. The April 10, 1978, rent levels, in the absence of reasonably anticipated appreciation or increase in future net income from the residential rental properties, do not allow average efficient landlords just and reasonable returns on their properties.

23. The absence of a significant decline in the value of Santa Monica rental properties primarily results from the purchasers' belief that rent controls will be lifted—that is, speculation that either the electorate may eliminate rent control or the courts may hold the Rent Control Amendment wholly or partially unconstitutional. Without such speculation, the value of controlled rental properties would decrease substantially. The amount of such decrease would depend principally upon the rent allowable under the Rent Control Amendment. This amount would vary from building to building depending upon subjective factors such as the current owner's historic cash investment, the method and rates of financing the property, the owner's tax bracket and other factors used in computation of rents in Regulation 4040.

24. Regulation 4040, applied to a hypothetical building purchased in 1969 for $63,500 with a zero cash flow in 1978, would result in the owner being allowed a $293.45 net cash return, assuming that the landlord could first rebut the presumption that the zero cash flow provided him a just and reasonable return. Assuming that the building were a typical building with usual financing and with the average

appreciation, the value of the owner's equity on April 10, 1979, would exceed $100,000.

25. As a result of the substantial appreciation in controlled rental properties prior to April 10, 1979, the use of the historic cash investment standard has and will result in confiscatory rent levels for the average landlord.

26. The effect of the use of the historic cash investment standard, as set forth in Regulation 4040 and applied by the Board, together with Sections 1805(f) and (g), is either now, or in the immediate future, to appropriate, without compensation, that portion of the value of residential rental property which represents the appreciation of the property from the date of its purchase to the present.

27. The Rent Control Amendment has reduced rental income for owners of Santa Monica controlled rental properties by $28 million to $54 million per year. The capitalized loss to such owners amounts to between $335 million to $648 million.

28. General rent adjustments under the Rent Control Amendment may be allowed pursuant to either Section 1805(a) or 1805(b). The adjustments under 1805(b) are annual and are to compensate the landlord for increased taxes, maintenance and utilities and to decrease the rent for any decreases in taxes. Rent increases allowed by Section 1805(a) are determined by the factors set forth in 1805(e).

29. The Board to date has authorized two rent increases for all controlled rental units registered with the Board: a 7 percent rent increase effective in August, 1979 and a 6.5 percent rent increase effective in August, 1980. The Consumer Price Index for all items, rose from 195.4 in April 1978 (the rollback date for base rents under the Rent Control Amendment) to 217.4 in 1979 and to 249.4 in August, 1980.

30. Neither general rent adjustment to date has been made pursuant to Section 1805(b). The first general rent adjustment did not reduce rents for a calculated corresponding reduction in property taxes pursuant to 1805(b)(3). Also, both the first

and the second rent adjustments allowed for an increase in the average landlord's net income by an amount equal to the rise in the preceding year of the Consumer Price Index. Regulation 4040, adopted September 18, 1980, would preclude any future allowances for increase in profit levels for future general rent adjustments.

31. The general adjustments allowed by the Rent Control Board do not provide increases for the increased costs of capital improvements, replacement of items with an expected life of over one year, or for any contingencies which do not occur on a regular basis.

32. The general rent increases allowed under Section 1805(b) and those provided by the Rent Control Board under Section 1805(a) are insufficient, when considered in connection with the delays and difficulties in applying for individual rent increases, to avoid widespread confiscatory results.

33. The individual rent increases allowed by the Rent Control Board both before and after the adoption of Regulation 4040 do not show sufficient individual increases to make the results of the general adjustments non-confiscatory in their ultimate effect.

34. Even if the landlords' net return were increased annually an amount equal to the Consumer Price Index, such increases in the landlords' net returns are still insufficient to avoid widespread confiscatory results, since the landlords' average net return on April 10, 1978, amounted to between 1 and 2 percent of the value of their property.

35. The necessary effect of Sections 1805(f) and (g) is, and will be, to reduce the value of residential rental properties depending principally upon the rent allowable under the Rent Control Amendment.

36. The necessary effect of Sections 1805(f) and (g) is, and will be, to preclude owners from receiving a just and reasonable return on the value of their properties beyond that reasonably necessary to achieve the purposes of the Rent

Control Amendment and to inhibit the alienation of controlled rental properties.

37. Section 1805(g) will, in some instances, preclude a buyer, after April 10, 1979, from receiving rent increases which the seller would have been entitled to receive.

38. Investments in residential rental property are fundamentally different from investments in public utility stocks for the following reasons:

(a) Public utility stocks are purchased primarily for current return rather than for deferred capital gain and future returns. Residential rental property in the City of Santa Monica, by contrast, is normally purchased primarily for future gain through appreciation or increased income rather than for current income. Increases in the value of residential rental property and reasonable expectation of increased future income generally represents the owners' principal return.

(b) Investors in public utilities purposely devote the utilities' property to public use and expect compensation in the form of regulated rates assured by the utilities' guaranteed monopoly. Prior to April 10, 1979, owners of Santa Monica residential rental property reasonably had no comparable expectations; their property was not devoted to public use; and they have, and have had, no monopoly position comparable to that of the public utilities.

(c) If a utility is unable to receive a fair return, it may withdraw its property from the regulated market. Under the Rent Control Amendment, and the Board's regulations and decisions, owners of controlled rental properties are virtually unable to remove their properties from the controlled rental market.

(d) Public utilities make substantial continuing investments to renovate and replace their equipment, expand service, and expand or supplement existing networks. Thus, historic cost relates in the case of public utilities not only to original acquisition or construction, but to a continuing series of substantial investments to which successive "historic investment" valuations apply. Residential rental property requires less continuing investment.

(e) Assets of public utilities are often essentially unique, so that it is not meaningful to speak of their market value. Apartment buildings, on the other hand, are bought and sold all the time. It is meaningful to consider their market value, although that value may be difficult to ascertain with accuracy in any given case.

39. The average Santa Monica landlord's net profit in April, 1978 was 6.74 percent of the gross rent dollar received.

40. The conditions for removal permits under Section 1803(t), together with the Board's implementing regulations and its decisions virtually preclude any landlord from receiving a permit which would allow him to cease operating his property as controlled rental property.

41. The overall effect of the Rent Control Amendment, Regulation 4040 and the interpretation and application of the Amendment and Regulation by the Rent Control Board, is to produce, either now or in the immediate future, a confiscatory result upon the average efficient class of landlords operating residential rental property in the City of Santa Monica.

42. Registration fees imposed by the Rent Control Board are designed for the purpose of defraying regulatory expenses necessarily incurred in connection with the Rent Control Amendment.

PROPOSED CONCLUSIONS OF LAW

The Court hereby makes the following conclusions of law:

1. Plaintiffs, and each of them, have standing to bring this action both as taxpayers seeking to prevent a waste of public funds and as owners of controlled rental properties seeking a judicial declaration as to their rights, duties and responsibilities under the Rent Control Amendment, on its face and as it has been interpreted and applied by the Rent Control Board.

2. The appropriate evidentiary standard in this action is "preponderance of the evidence." However, the evidence necessary to support the Court's decision herein has been "clear and convincing" and, therefore, the appropriate evidentiary standard has no significance in this action.

3. Rent control is in general a proper exercise of the municipal police power, but only so long as its provisions do not necessarily lower rents more than could reasonably be required for the measure's stated purpose and its provisions provide landlords with just and reasonable returns on their properties.

4. Governmental action in the absence of a physical taking may constitute a taking without due process of law in violation of the Fifth and Fourteenth Amendments of the Constitution of the United States and of Sections 1, 7 and 19 of Article 1 and Section 7 of Article 11 of the California Constitution. Whether the governmental action constitutes such a taking requires an examination of the economic impact of the regulation, its interference with reasonable investment backed expectations and the character of the government action to determine whether justice and fairness require that the economic injuries caused by the public action should be compensated by the government, rather than remain disproportionately concentrated on a few persons.

5. The constitutionality of rent control laws and regulations adopted in connection therewith are not determined upon the same constitutional considerations applied to zoning

ordinances. In zoning cases, the use to which the land may be put is prospective and the landlord has not yet obtained the same type of "vested" right of an owner who has constructed or now owns residential rental property. In addition, zoning, unlike rent control, involves reciprocal benefits and burdens for all segments of the affected population. The benefits to landlords under the Santa Monica Rent Control Amendment are virtually nonexistent.

6. "Investment," as defined by Regulation 4040 and otherwise applied by the Board (herein referred to as historic cash investment), is constitutionally impermissible as a basis for measuring the constitutionality of returns on residential rental property.

7. Use of the historic cash investment standard produces widespread, confiscatory results in violation of the Fifth and Fourteenth Amendments of the United States Constitution and Sections 1, 7 and 19 of Article 1 of the California Constitution. A confiscatory result is a net return which does not provide the landlord with a just and reasonable return on his property.

8. The historic cash investment standard makes constitutionally impermissible distinctions between owners of virtually identical properties in violation of the equal protection clause of the Fourteenth Amendment of the United States Constitution and Section of Article 7 of the California Constitution.

9. If California law applicable to public utilities were applied to controlled residential rental property, the owners thereof would be entitled to a return based on the fair market value of their property as of April 10, 1979.

10. Deciding whether a rent regulation permits a just and reasonable return requires consideration of the value of the rental property, the reasonable expense of operating the property, the income, the rate of return on the value of the property actually permitted by the rent regulations and the

minimum rate of return which would be just and reasonable for that property.

11. For purposes of determining a just and reasonable return on residential rental property under a rent control ordinance or regulation, the value of the property should be interpreted as the fair market value of such property, as defined by Section 1263.320 of the Code of Civil Procedure; and as determined upon the basis of relevant evidence thereof as set forth in Division 7, Chapter 1, Article 2 of the California Evidence Code. Since data for rental properties in relevant markets is readily available, historic cash investment is not a permissible factor upon which an expert may reasonably rely in forming an opinion as to the value of residential rental property; nor may sales of the subject property be taken into account, unless such sales occurred within a reasonable time before or after the date of value.

12. The effect of the Rent Control Amendment itself and the Rent Control Board's interpretation and application thereof may not be considered in determining the value of the controlled rental property.

13. In each instance, in the Rent Control Amendment, in which the phrase "return on investment" is used said phrase shall be interpreted to mean "return on the value of the property" in order to give a constitutionally valid construction to the language of the Amendment.

14. The reduction in rent to those levels in effect one year before enactment of the Rent Control Amendment (*i.e.*, April 10, 1978) when the market was assumed to be in equilibrium is constitutionally permissible, provided adjustments are made to allow for the effects of inflation to April 10, 1979.

15. The presumption that April 10, 1978, rents assured owners a just and reasonable return, as defined by Regulation 4040 and otherwise applied by the Board, violates Sections 1, 7 and 19 of Article 1 and Section 7 of Article 11 of the California Constitution, as well as the Fifth and Fourteenth Amendments of the United States Constitution.

16. That portion of the next to last sentence of Section 1805(e) reading "the speculative nature of the investment, whether or not the property was acquired or is held as a long-term or short-term investment . . ." is unconstitutional in that it violates the equal protection clause of the Fourteenth Amendment, making arbitrary distinctions with no rational basis among owners of similar properties, on the basis of such subjective criteria as individual motives and length of ownership and denies a significant number of owners their right to a just and reasonable return on their property in violation of Sections 1, 7 and 19 of Article 1 and Section 7 of Article 11 of the California Constitution, as well as the Fifth and Fourteenth Amendments of the United States Constitution.

17. Sections 1805(f) and (g) are unconstitutional in that they:

(a) deny owners their constitutional right to a just and reasonable return on their property;

(b) make arbitrary distinctions with no rational basis among owners of equal properties on the basis of the purchase dates, financing terms, original purchase price, and other subjective factors; and

(c) appropriate past return in the form of appreciation on the arbitrary, subjective, and individual bases identified in the foregoing sub-paragraph.

Said sections violate Sections 1, 17, and 19 of Article I and Section 7 of Article 11 of the California Constitution, as well as the Fifth and Fourteenth Amendments of the United States Constitution.

18. Regulation 4040 is unconstitutional on its face and as applied. The provisions thereof are so intertwined that those portions which may be constitutional cannot be severed.

19. Section 1812 of the Rent Control Amendment is a valid severability clause and those portions of the Amendment herein determined to be unconstitutional may be severed from the remainder.

20. The Rent Control Board's registration fees are not in violation of Article XIIIA of the California Constitution.

21. For the Rent Control Board to require appropriate tax return information in connection with petitions for rent increase is not violative of law.

To extent that any of the foregoing conclusions of law incorporate or represent findings of fact, or vice versa, they shall be so construed.

Dated: _____

_____

Richard A. Lavine
Judge

ORIGINAL FILED

FEB 17 1982

COUNTY CLERK

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

JAMES W. BAKER, et al., Plaintiffs, v. CITY OF SANTA MONICA, et al., Defendants	CASE NO. WEC 058763 (Transferred to South Central) (District)
SANTA MONICANS FOR RENTERS' RIGHTS, et al., Interveners	
JOHN J. STEIN, et al., Plaintiffs, v. CITY OF SANTA MONICA, Defendant.	CASE NO. WEC 059251 (Transferred to South Central) (District)

APPENDIX-F

SANTA MONICANS FOR RENTERS' RIGHTS, et al., Interveners.	ANNOUNCEMENT OF INTENDED DECISION PHASE II (Pursuant to Cal. Rules of Court) (232 and 232.5, Eff. Jan. 1, 1982)

A. INTRODUCTION

1. Announcement of Intended Decision and Statement of Decision

a. This Intended Decision is made pursuant to Rules 232 and 232.5 of the California Judicial Council, as amended and effective January 1, 1982. For convenience of counsel, the clerk encloses herewith copies of such amendments.

b. Counsel during argument and trial have heretofore requested Findings of Fact and Conclusions of Law for this Phase II, prior to the effective date of the amendment of Code of Civil Procedure §632 and announcement by the Judicial Council of the amended Rules as cited above. Such Findings have been procedurally superseded by Announcement of Intended Decision followed by a Statement of Decision, if requested by parties.

c. Because of this change in California procedure between the time of trial and argument of Phase II and the date of this Announcement of Intended Decision, the court interprets the previous request for Findings to be equivalent to a request for a Statement of Decision. Hence any proposals as to contents to Statement of Decision shall be made within ten (10) days of this Announcement of Intended Decision, issued on February 17, 1982. Pursuant to Rule 232(g), should any party require additional time to submit such proposal, such party is invited to request such additional time.

d. Thereafter it is the intention of this court to prepare and mail a proposed Statement of Decision within fifteen (15) days after expiration of the time for proposals, pursuant to Rule 232(c).

e. No proposed judgment is necessary at this time, as set forth in Rule 232.5, as bifurcated issues are to be tried at a later time, Par.A.2.f. *infra*.

2. Nature and Effect of Phase II

a. In Phase I the court considered certain aspects of the constitutionality of the City of Santa Monica Charter Amendment referred to hereafter as the "Rent Control Amendment" together with the then existing Regulation 4040 and associated regulations. The court issued its Memorandum of Intended Decision (under the old procedure) on March 6, 1981. Findings of Fact and Conclusions of Law (under the old procedure) were signed by the court on July 27, 1981.

b. Pursuant to request of defendant City of Santa Monica, the court allowed defendants to come up with a new plan or regulations which may satisfy the constitutional infirmities of the Rent Control Amendment and its then regulations. Upon further request of defendants, this period of time was extended by the court. On August 17, 1981, defendants submitted a new plan and regulations, namely Sections 4100 through 4111, hereafter referred to as the "4100 Regulations." Such 4100 Regulations went into effect in the City of Santa Monica on October 19, 1981.

c. Trial of the issues of the constitutionality of the 4100 Regulations and associated issues, including the issue of whether the 4100 Regulations were *ultra vires* to the terms of Rent Control Amendment came on regularly for trial on September 24, 1981 in Department G (formerly Department C) of the South Central District, Richard A. Lavine, Judge presiding without a jury. The case was tried and argued on September 24, 25, and 30; October 1, 6, 7, 9, 13, 14, 15, 19, 20, 21, 22, 26, 27, 28, 29 and 30; November 3 and 17; and December 18 and 21, 1981.

d. The court heard and considered the evidence, both oral and documentary introduced on behalf of the parties,

and being fully advised makes this Announcement of Intended Decision. Pursuant to Rule 232.5, this Announcement of Intended Decision is limited to issues not heretofore determined in Phase I. In addition, certain issues are bifurcated and reserved for hearing in Phase III, as set forth in Par. A. 2.f *infra.*

e. The City Attorney for Santa Monica suggests, that if the court finds the 4100 Regulations constitutional that it consider which portions, if any, of the Rent Control Amendment may render *ultra vires* such 4100 Regulations; and that if the court so considers, the court may have the power to declare unconstitutional such offending portions of the Rent Control Amendment at variance with the 4100 Regulations. The court adopts such suggested procedure, as amplified in Par. D. *infra.*

f. Defendants request that the court bifurcate and reserve for further trial (hereafter referred to as Phase III) the issue of the constitutionality of §1803(t) of the Rent Control Amendment dealing with Removal of Controlled Rental Unit from Rental Housing Market. The court accedes to such request and sets down for hearing commencing March 12, 1982 the following issues:

(1) The constitutionality of §1803(t) of the Rent Control Amendment; and

(2) The award of attorney fees, if any, for Phases I, II and III of this case.

g. Counsel for all parties have requested that except for the issues reserved for Phase III, as described above in Par. A.2.f., no additional issues be bifurcated or reserved for further proceedings. Therefore this court does not intend to bifurcate or reserve for future proceedings any issues except those reserved for Phase III. This supersedes the previous reservation of issues as set forth in Findings of Fact and Conclusions of Law p. 2, l, 21-22, dated July 27, 1981, including issues set forth in the Pretrial Statement and Order dated November 14, 1980.

h. Except to the extent inconsistent, the court incorporates herein its Memorandum of Intended Decision dated March 6, 1981, and Findings of Fact and Conclusions of Law dated July 27, 1981. In the event of a contradiction, discrepancy or ambiguity between the terms of this Announcement of Intended Decision with the former Findings of Fact and Conclusions of Law dated July 27, 1981, or the Memorandum of Intended Decision dated March 6, 1981 this Announcement of Intended Decision shall control.

B. DESCRIPTION AND CHARACTERISTICS OF 4100 REGULATIONS.

1. Some of the characteristics of the 4100 Regulations are:

a. In determining "fair return", the net operating income or "return on value" approach is used in contrast to the impermissible historic value approach employed in the previous set of regulations. The net operating income (NOI) equals the gross income less operating expenses (§4101(a)). Gross income equals the sum of gross rents, interest from rental deposits, income from miscellaneous facilities, and all other income received from use or occupancy of rental units. From this is subtracted uncollected rents due to vacancies and bad debts (§4101(h)). Operating expenses include real property taxes, utility costs, management expenses, normal repair and maintenance, owner performed labor, license and registration fees, and capital expenses (at a total cost of less than $100. per benefited unit, and amortized portion of capital expenses otherwise allowed by regulations). Operating expenses do not include avoidable expenses, mortgage principal and interest payments, penalties or fees incurred for violations, certain legal fees, depreciation, or any reimbursed expenses (§4101(c)).

b. It is presumed that NOI produced by the property in the base year of 1978 provided a fair return (§§4101(e) and 4102) (*Birkenfeld, supra* 165). This presumption may be rebutted by a finding by the Hearing Examiner in a manner set forth in §4103.

c. The Rent Control Board may permit individual petitioners to increase rents so that landlord's NOI will be increased at 40% of the increase in Consumers Price Index (CPI) over the base year 1978 (§4106). The CPI is that for all urban consumers for the Los Angeles, Long Beach, Anaheim Metropolitan Area (All Items) (§4103(f)). There is a limit on annual increases of not more than twice the Employment Cost Index (§4107).

d. An individual adjustment shall take into account any General Adjustment and is limited accordingly. General adjustments are to be calculated consistent with the 4100 Regulations (§4108).

e. §4109 gives a landlord a choice to keep any individual adjustment given under previous regulations; or to relinquish previous rights and to petition under the 4100 Regulations.

2. The growth in profits is tied to the inflation rates. The typical landlord who purchased rental income property prior to the late 1970's probably financed the purchase of the property by a fixed rate loan (in California by a note secured by a deed of trust). For such typical landlord, the fixed rate of interest means no increase in original debt service costs caused by inflation. In the late 1970's variable interest rate real property loans became increasingly more common.

3. This NOI or "return on value" approach to rent regulation is similar to that utilized in New Jersey and some Massachusetts communities. The method was approved in *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 394 A2d 65 (1978), also holding that a "value based criterion" is practically unworkable in a rent controlled context (at p. 72). The principal objection to the value based criterion is that it is "practically unworkable" in a rent controlled context because of the alleged circularity effect. That is to say, if rents were uncontrolled values may spiral, so how can one calculate a fair rate of return upon uncontrolled spiralling prices? I do not share the extreme pessimism of the New Jersey Supreme Court; for as plaintiffs attempted to demonstrate

in the trial of Phase II, it is possible to use base year (1978) actual market values, to interpolate for known years, then extrapolate for a limited number of future years utilizing certain facts and assumptions as to changes in CPI, changes in interest rates, etc. Where the court parts company with plaintiffs' conclusions and arguments, as will be expanded upon below, is that the extrapolation method may be valid in a court of law in this type of case only for a limited number of years. If extrapolation is attempted beyond a limited number of years, there are so many variables that the minimum test of proof by a preponderance of evidence required in the courts is not met . . . and the opinions of the expert witnesses, although buttressed by their economic mathematical calculations, become speculative.

Use of modern "mass appraisal" techniques may give more practicality to the return on market value criterion in testing constitutionality of rent control legislation, as well as providing a practical means of expediting calculation of rent adjustment by rent control boards and the petitioners seeking individual rent increases. But whether the NOI approach or a strict return on market value approach is used may not be the crucial constitutional test. As all sides agree, and this court concurs, it is the result that counts with respect to the constitutional requirement of providing a fair return to the landlords. (*Birkenfeld, supra* 165)

4. The evidence showed that a rent control plan should have the following characteristics, which are possessed by the NOI method:

a. The standard cannot be manipulated; standards which take into account current mortgage payments and/or purchase price can be manipulated through sales and refinancing: In testing whether a rent control plan is constitutional, the court need not consider individual financing arrangements. See *Zussman v. Rent Control Board of Brookline,* 371 Mass. 632, 359 N.E. 2d 29, 33-34; and *Helmsley, supra* at 394 A3d 80;

b. The NOI standard does not discriminate on the basis of "original" purchase price or financing arrangements, which this court found faulty in the old regulations in Phase I;

c. The analysis is simple to perform and is objective;

d. The standard is not "circular". For criticism of circularity see *Troy Hills v. Township Council,* 68 N.J. 604, 350 A2d 34, 44 (1975);

e. The standard affords a growth in profit levels that is tied to the inflation rate.

f. The method encourages housing maintenance, because it permits landlords to pass through to tenants all operating expense increases regardless of profit levels.

C. CONSTITUTIONAL CONSIDERATIONS AS TO 4100 REGULATIONS

1. Phase II does not consider whether the Rent Control Board has or will handle individual rent control petitions in a constitutional manner. Since the 4100 Regulations only went into effect on October 19, 1981 during the midst of this hearing, the parties have not put into issue whether practical implementation of the 4100 Regulations has been constitutional. This is a matter that may be left for future administrative mandamus proceedings, or a later possible plenary action.

2. This court does not consider whether rent control in the abstract may be a proper exercise of the police power. The California Supreme Court in *Birkenfeld v. City of Berkeley,* 17 Cal. 2d 129, 130 Cal Rptr 465, 550 P2d 1001 (1976) holds that rent control in general is a proper exercise of the municipal police power.

3. The parties agree, and this court concurs, that the imposition of the 4100 Regulations has not constituted a "taking of property" as of the date of this decision. See *San Diego Gas & Electric Co. v. City of San Diego* (1981) 101 S.Ct. 1287.

4. This court may not and does not consider whether rent control regulation in the City of Santa Monica is wise or unwise. Such determination is a legitimate function of the legislative as opposed to the judicial function of government. *Birkenfeld* at 144 and 159.

5. The expert witnesses produced by all the parties agree, and this court concurs, that the return on investment of owners of rental property includes not only net operating income but also the reasonably anticipated increase in real property values as such has been anticipated in the last number of years, more particularly in 1978, the base year. However, this court is not bound to give to all owners all of their 1978 expectations. An ordinance otherwise properly within the police power does not become unconstitutional merely because, as a result of its operation, property does not achieve its maximum economic potential. *Maher v. City of New Orleans,* 516 F.2d 1051, 1065 (1975). Also as the evidence shows, reasonable expectations in 1978 have their "down" side as well as their "up" side.

6. As set forth in the Memorandum of Intended Decision, Par. C.8. dated March 6, 1981 (See *Birkenfeld* at 165, 169), a property owner whose property is regulated is entitled to a just and reasonable return upon his property. One definition of a just and reasonable return is a return which is commensurate with returns of investments in other enterprises having corresponding risks. That return should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain credit and to attract capital. The latter definition is tailored to fit public utilities, which may or may not differ from rental housing properties *FPC v. Hope Natural Gas, infra* at 320 U.S. 605.

7. Mere reduction in property values caused by regulation such as public utility rate-making or rent control regulation is not *ipso facto* unconstitutional. *Permian Baisin Area Rate Cases,* 390 U.S. 747, 769, 20 L.Ed. 2d 312, 337 (1968); *FPC v. Hope Natural Gas,* 320 U.S. 591, 601, 88 L.Ed. 333, 344

(1944); and *Troy Hills, supra* at 68 N.J. 617, 350 A3d at 47.

8. Existing case law does not afford any precise standard as to what rate of return property owners in a regulated market are entitled to receive so that the court may employ a "litmus paper" test. Another way of putting the question is to ask, "What is the precise rate of return below which any system of rental regulation will be considered as affording an unconstitutional rate of return to property owners?" *Birkenfeld* does not furnish us with any such precise standard, and implies that the City of Berkeley rental ordinances fell substantially below any such precise standard. The New Jersey Supreme Court has wrestled with this problem in a series of recent cases cited in this Announcement but has failed to define a precise standard. However, the New Jersey Supreme Court has held that "The rate of return permitted need not be as high as prevailed in the industry prior to regulation nor as much as an investor might obtain by placing his capital elsewhere." *Hutton Park Gardens, Town Council* 68 N.J. 543, 350 A.2d 1, 15 (1975). The parties in this case were invited by the court to argue for their respective versions of a precise standard; and the court means no criticism of the parties, their counsel, or the learned expert witnesses to state that no precise standard has been proffered for the court's guidance.

The United States Supreme Court has rejected the older concept of substantive due process wherein it was assumed that there is some "fair" rate of return that persons are entitled to under the due process clauses of the 5th and 14th Amendments of the U.S. Constitution. Compare *Lochner v. New York*, 198 U.S. 45 (1904) more particularly Justice Holmes' dissent 75-76. See *Birkenfeld, supra,* 154-156. However, in considering the "taking" clause of the 5th Amendment, (". . . nor shall private property be taken for public use, without just compensation"), courts must necessarily consider that if the rate of return permitted under a particular regulation falls below *some* low rate, that this

constitutes a "taking" and/or an impermissible exercise of the police power. If we were in an economic era in which interest rates did not fluctuate and the rate of inflation were low or non-existent, it would be easier to propose such a minimum rate of return. Is it surprising that in these days of interest rates fluctuating substantially, and the rate of inflation undergoing similar fluctuations, it is much more difficult for appraisers, economists, lawyers, constitutional scholars[1] and the courts to arrive at a precise standard? See *Matter of South Bronx Neighborhood Dev. Plan,* (Sup). 442 N.Y.S. 2d 869 (1981).

In the trial of Phase II, the expert witnesses for both sides employed in giving their testimony and making their economic mathematical computations at least the following variable factors: (a) fluctuation in interest rates; (b) fluctuation in consumer price indices; (c) anticipated holding periods for purchasers of rental housing properties (i.e. is the holding period 10 years, 20 years, or some greater period?); (d) ratio between the value of the land and the value of the improvements upon real property (i.e. is it 50%, 60% or some other ratio in Santa Monica?); (e) whether purchasers of residential rental properties reasonably anticipate that the ratio between the land value and the value of improvements will be the same ratio at the end of the holding period as it was at the time of purchase, and if not what the proper ratio may be; (f) whether purchasers of residential rental properties reasonably anticipate that the ratio between NOI and purchase price will be the same at the end of the holding period as it was at the date of purchase, and if not, what the proper ratio may be.

Both sides offered expert testimony, buttressed by elaborate and well-presented economic mathematical calculations using various assumptions. Such assumptions can be validated for the past, where we may have concrete evidence. Such assumptions even may be extrapolated for several years based on reasonable assumptions and expectations of informed purchasers of residential income properties. But after several

years, the assumptions and expectations of necessity become more attenuated, more speculative. We do not know what the future has in store with reference to these variable factors. This dilemma of the economic experts was well expressed by a counsel for defendants who quoted the statement of David Stockman, Director of the Budget, namely, "None of us really understands what's going on with all these numbers." (*The Atlantic Monthly,* December 1981,27-54, at 38)[2].

9. The burden is upon plaintiffs to demonstrate or prove that the 4100 Regulations are unconstitutional. In Phase I, defendants urged that to hold the Rent Control Ordinance or the hold regulations unconstitutional, plaintiffs had the burden of proving such assertion by "clear and convincing evidence." Plaintiffs then countered by saying that in California the burden of proof was only by a preponderance of evidence. I did not find it necessary in Phase I to decide what should be the precise burden of proof. (Memorandum of Intended Decision, March 6, 1981, Par. C.9). I do not find it necessary for me to articulate that precise burden of proof in Phase II, for reasons set forth in Par. C.12. *infra.* See *Connolly v. Gen. Construction Co.,* 269 U.S. 385, 391 (1926); *U.S. v. Natl. Dairy Corp.* 372 U.S. 29, 32-33 (1963) and *Parker v. Levy,* 417 U.S. 733, 757 (1974).

10. In Phase I, plaintiffs endeavored to show that there was a decline in residential rental property values in Santa Monica as a result of the passage of the Rent Control Amendment and its implementation. Defendants presented evidence to the contrary. Dr. Shulman, testifying for defendants, stated in both Phases I and II that residential income property values have not dropped in Santa Monica following the establishment of rent control in April 1979. He gives as some of his reasons for what economists anticipated normally would be a decline following imposition of rent controls (a) anticipation by the buyers and sellers that there will be an end to rent control by the legislative process or by court action (I held that this reason was

impermissible in Phase I, and still so hold); (b) the land value is equal to or greater than the sum of the land and rent controlled building (or alternately and in a lesser sense, the ratio of land to improvements in Santa Monica residential properties is significantly higher than the ratios in other parts of Southern California). The testimony showed that there has been a great decline in the number of sales of residential rental properties in Santa Monica since April 1979 (as well as elsewhere), and that this decline in number of sales is due in large measure to the drying up of available financing caused by high interest rates.

Because of the decline in number of sales it is more difficult to adjudge as to whether the rent regulation has dried up the attraction and retention of capital. However, we do know that market values have not plummetted in Santa Monica (as might be expected) since residential rental property owners have not placed their properties on the market at substantially reduced prices in order to "unload."

Defendants argue that new construction may be attracted into the Santa Monica market because it is exempt from the provisions of rent control. We do not have evidence of this in Phase II, possibly because of the drop in new construction everywhere because of high interest rates, and also perhaps because of the possible shortage of available land in Santa Monica for new income residential construction.

We do not consider the economic effects of the restriction on alternate uses of the property (§81803(t) of the ordinance). This is reserved for Phase III.

11. The 4100 Regulations affect different classes of landlord in varying ways. Landlords who purchased properties in the 1960's and earlier may fare satisfactorily under the 4100 Regulations, so the evidence shows. Landlords who purchased in the early 1970's may not be happy with the 4100 Regulations, but they do not appear to be affected in the sense that the regulation is unconstitutional as to them. Plaintiffs urge that the 4100 Regulations are clearly

unconstitutional when applied to those landlords who purchased in the late 1970's, because the latter purchased at high purchase prices in relation to the NOI in anticipation that a large measure of their eventual return on investment would be realized through continued appreciation in property values.

In the class of landlords who purchased in the late 1970's, there is a sub-class who must have purchased in late 1978 or prior to April 1979 with the realization that the Rent Control Amendment would be on the ballot and had a good chance of passage. Such sub-class can be expected to have had discounted the chances for and against passage of the Rent Control Amendment in their offers which resulted in the purchase of their properties. We cannot say as to this sub-class that there has been a curtailment of an investment-backed reasonable expectation. *Graham v. Estuary Properties* (Fla., 1981) 399 So. 2d 1374. See *Flynn v. City of Cambridge,* (Mass., 1981) 418 N.E.2d 335, 339-340.

Those landlords purchasing in the 1970's who may be aggrieved by any denial of an individual petition under the 4100 Regulations may have redress to the courts through administrative mandamus proceedings. This court is ruling as to the generality of the constitutionality of the 4100 Regulations and not as to its effect upon *every* landlord. See *Birkenfeld* at 172.

But can we anticipate that land values even in Santa Monica will continue to appreciate in the 1980's, the 1990's and beyond at the same rate as in the 1970's? Asking the question in a more narrow and constitutional context, *must* we assume the same rate of appreciation, or even any appreciation at all?

12. The court finds that the plaintiffs have failed to meet their burden of proof that the 4100 Regulations are unconstitutional, even if we may employ the lower standard of burden of proof by a preponderance of the evidence. The quality of the evidence produced by all parties was excellent.

Yet the testimony of experts on both sides failed to convince this court that the long-term results predicted by each set of respective experts would be more likely to occur than not to occur. Since plaintiffs have the burden of proof, whereas the defendants do not have such burden, the court's conclusion is that as of the time of this Announcement of Intended Decision the provisions of the 4100 Regulations are not unconstitutional under California or federal constitutional standards.

D. ARE THE 4100 REGULATIONS *ULTRA VIRES* UNDER THE RENT CONTROL AMENDMENT?

1. This presents two questions rather than one:

a. Is any portion of the 4100 Regulations facially in conflict with any other provision of the Rent Control Amendment?

b. If so, is the affected provision of the Rent Control Amendment constitutional?

2. Plaintiffs object to the fact that the Rent Control Board has come up with a new set of regulations that set forth in detail the factual and economic factors which the board may consider in contrast to the general statements set forth in the Rent Control Amendment. §1803(f) (5) merely requires the Board to "Set rents at fair and equitable levels in order to achieve the intent of this Article." The delegation to the Board of setting forth the mode of achieving the purpose of the Amendment is sound administrative action. Kenneth Culp Davis in the authoritative American text: *Administrative Law Treatise* (West, 1958) §2.15, p. 149 aptly states this proposition:

> "The difficulty is that it is often affirmatively desirable for the legislative body to avoid either an intelligible principle or a clear delineation of the general policy, for the simply reason that many questions of basic policy may better be worked out

> by an agency than be a legislative body. For instance, the legislative body maysay to the zoning board, in effect: 'What we want is a good system of zoning. We want you to protect both private interests and public interests. If you want to know what we mean by 'good' we are not prepared to tell you. Neither can we tell you how to accommodate private interests and public interests when they clash. That's your job. You can do it better than we can because we have to operate in wholesale fashion, whereas you can make concrete decisions in the light of all the facts and circumstances of particular cases.' For a legislative body to make this kind of statement is sometimes both good sense and good government. The legislative body itself is usually the best judge of the extent to which it should attempt to state an intelligible principle. When Congress decided to go no further in guiding the FCC than to say 'public convenience, interest, or necessity,' the Supreme Court wisely observed that 'this criterion is as concrete as the complicated factors for judgment in such a field of delegated authority permit. . . .'" (*FCC v. Pottsville Broadcasting Co.*, 309 U.S. 134, 138, 84 L.Ed 656 (1940).)

Davis cites (in his 1970 Supplement, §2.15) *In re Peterson*, 51 Cal.2d 177, 331 P. 2d 24, 77 ALR2d 1291 (1958), app. dismissed 360 U.S. 314, 3 L.Ed.2d 1259 in support of his statement. Far more authoritative is *Birkenfeld* at 167-169, citing Davis.

§1803(g) provides that "The Board shall issue and follow such rules and regulations, including those which are contained in this Article, as will further the purposes of the Article." Thus the Rent Control Amendemnt in conjunction with its elaborate regulations follows the division of labor recommended by Professor Davis.

3. §1805(b)(3) provides in part that ". . . In adjusting rents under this subsection, the Board shall adopt a formula of general application . . ." The 4100 Regulations track this section of the ordinance by providing in §4108 in part ". . . The Board is authorized to calculate and establish any General Adjustment consistent with this Subchapter."

4. With reference to §1805(e), in Phase I in the Memorandum of Intended Decision Par. E.2.a(3)(a), this court said "(a) That portion of the next to the last sentence reading ". . . . the speculative nature of the investment, whether or not the property was acquired or is held as a long term or short term investment . . ." is held to be unconstitutional and must be stricken if the ordinance as a whole is to be sustained. I further find that such stated portion is severable from the ordinance as a whole." The 4100 Regulations, more particularly §4101 are not in accord with §1805(e). This court in Phase II reiterates that the portion of §1805(e) quoted above is unconstitutional, yet is severable from the rest of the ordinance.

5. With further reference to §1805(e), in Phase I in the Memorandum of Intended Decision, Par. E.2.a.(3)(b)., this court said, "(b) That portion of the next to the last sentence reading ". . . and the landlord's rate of return on investment", and the final sentence reading: "It is the intent of this Article that upward adjustments in rent be made only when demonstrated necessary to the landlord making a fair return on investment" may be construed as constitutional if the phrase "return on investment" in each instance is equated to mean "return on property." "Return on property" I take to mean the "return on fair market value of the property" This construction is in accordance with the California cases cited for this proposition above, and is done so as to construe as much of the ordinance as can be done as constitutional."

The 4100 Regulations do not use the "return on investment" approach utilized in the former 4040 Regulations. I reiterate that I construe that "return on investment" as used in the Rent Control Amendment is equated to mean "return on

property." This is the test laid down in *Birkenfeld* at 165. See *U.S. v. General Motors,* 323 U.S. 373, 378, 89 L.Ed. 311, 318 (1945).

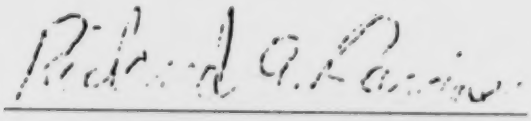
6. With reference to §1805(f) and (g), in Phase I in the Memorandum of Intended Decision, Par. E.2.a.(4), this court found such sub-paragraphs to be unconstitutional. However, it appears that the 4100 Regulations, more particularly §§4101, 4103, 4104, do not authorize the Board to consider as a factor for an individual rent increase the fact of negative cash flow either by reason of refinancing or at the time of acquisition. Therefore §1805(f) and (g) do not appear to be relevant to this comparison between the Rent Control Amendment and the 4100 Regulations.

7. For the reasons stated above, the 4100 Regulations are not *ultra vires.*

The clerk is ordered to mail forthwith to all parties who appeared at the trial a copy of this Announcement of Intended Decision.

(Rule 232 (a)).

DATED: FEBRUARY 17, 1982



RICHARD A. LAVINE
Judge of the Superior Court

FOOTNOTES

[1]In the closely related subject of what constitutes a "taking" for inverse condemnation purposes, the courts and scholars have long considered and debated what are the proper tests to use in drawing the line between non-compensable police power actions, and those "takings" which are compensable. The economic effect upon the property owner is one of the considerations which has plagued those endeavoring to draw the line. The scholars have been unable to distinguish clearly the U.S. Supreme Court cases in this area. See:

a. *Griggs v. Allegheny County in Perspective: Thirty Years of Supreme Court Expropriation Law*, Allison Dunham in 1962 Sup. Ct. Rev. 63;

b. *Takings and the Police Power*, Joseph L. Sax in 74 Yale L.J. 36 (1964);

c. *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, Frank L. Michelman in 80 Harvard L.R. 1165 (1967);

d. *Taking or Damaging by Police Power: The Search for Inversse Condemnation Criteria*, Arvo Van Alstyne in 44 So.Cal.L.R. 1 (1970);

e. *A Policy Analysis of the Taking Problem*, 49 New York L.R. 165 (1974).

[2]"None of us really understand what's going on with all these numbers," Stockman confessed at one point. "You've got so many different budgets out and so many different baselines and such complexity now in the interactive parts of the budget between policy action and the economic environment and all the internal mysteries of the budget, and there are a lot of them. People are getting from A to B and it's not clear how they are getting there. It's not clear how we got there, and it's not clear how Jones is going to get there."

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SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

JAMES W. BAKER, et al., Plaintiffs, v. CITY OF SANTA MONICA, et al., Defendants.	CASE NO. WEC 058763 (Transferred to South Central) (District) STATEMENT OF DECISION PHASE II
SANTA MONICANS FOR RENTERS' RIGHTS, et al., Interveners.	
JOHN J. STEIN, et al., Plaintiffs, v. CITY OF SANTA MONICA, Defendant.	CASE NO. WEC 059251 (Transferred to South Central) (District)

SANTA MONICANS FOR RENTERS' RIGHTS, et al.,
Interveners.

A. INTRODUCTION

1. Announcement of Intended Decision and Statement of Decision

a. Pursuant to Rules 232 and 232.5 of the California Judicial Council, as amended and effective January 1, 1982, the court issued an Announcement of Intended Decision on February 17, 1982.

b. Having received and read counsel's proposals and objections thereto, and good cause appearing therefor, the court issues this Statement of Decision.

2. Nature and Effect of Phase II

a. In Phase I the court considered certain aspects of the constitutionality of the City of Santa Monica Charter Amendment referred to hereafter as the "Rent Control Amendment" together with the then existing Regulation 4040 and associated regulations. The court issued its Memorandum of Intended Decision (under the old procedure) on March 6, 1981. Findings of Fact and Conclusions of Law (under the old procedure) were signed by the court on July 27, 1981.

b. Pursuant to request of defendant City of Santa Monica the court allowed defendants to come up with a new plan or regulations which may satisfy the constitutional infirmities of the Rent Control Amendment and its then regulations. Upon further request of defendants, this period of time was extended by the court. On August 17, 1982, defendants submitted a new plan and regulations, namely Sections 4100 through 4111, hereafter referred to as the "4100 Regulations." Such 4100 Regulations went into effect in the City of Santa Monica on October 19, 1981.

c. Trial of the issues of the constitutionality of the 4100 Regulations and associated issues, including the issue of

whether the 4100 Regulations were *ultra vires* to the terms of Rent Control Amendment came on regularly for trial on September 24, 1981 in Department G (formerly Department C) of the South Central District, Richard A. Lavine, Judge presiding without a jury. The case was tried and argued on September 24, 25, and 30; October 1, 6, 7, 9, 13, 14, 19, 20, 21, 22, 26, 27, 28, 29 and 30; November 3 and 17; and December 18 and 21, 1981.

d. The court heard and considered the evidence, both oral and documentary introduced on behalf of the parties, and being fully advised made an Announcement of Intended Decision on February 17, 1982, and now makes this Statement of Decision. Pursuant to Rule 232.5, this Statement of Decision is limited to issues not heretofore determined in Phase I. In addition, certain issues were bifurcated and reserved for hearing in Phase III, as set forth in Par. A.2.f *infra.*

e. The City Attorney for Santa Monica suggests that if the court finds the 4100 Regulations constitutional that it consider which portions, if any, of the Rent Control Amendment may render ultra vires such 4100 Regulations; and that if the court so considers, the court may have the power to declare unconstitutional such offending portions of the Rent Control Amendment at variance with the 4100 Regulations. The court adopts such suggested procedure, as amplified in Par. D, *infra.*

f. Defendants request that the court bifurcate and reserve for further trial (hereafter referred to as Phase III) the issue of the constitutionality of Section 1803(t) of the Rent Control Amendment dealing with Removal of Controlled Rental Unit from Rental Housing Market. The court accedes to such request and sets down for hearing commencing March 12, 1982 the following issues:

(1) The constitutionality of Section 1803(t) of the Rent Control Amendment; and

(2) The award of attorney fees, if any, for Phases I, II and III of this case.

g. Counsel for all parties have requested that except for the issues reserved for Phase III, as described above in Par. A.2.f., no additional issues be bifurcated or reserved for further proceedings. Therefore this court does not intend to bifurcate or reserve for future proceedings any issues except those reserved for Phase III. This supercedes the previous reservation of issues as set forth in Findings of Fact and Conclusions of Law p. 2, l, 21-22, dated July 27, 1981, including issues set forth in the Pretrial Statement and Order dated November 14, 1980.

h. Except to the extent inconsistent, the court incorporates herein its Memorandum of Intended Decision dated March 6, 1981, and Findings of Fact and Conclusions of Law dated July 27, 1981. In the event of a contradiction, discrepancy or ambiguity between the terms of this Statement of Decision with the former Findings of Fact and Conclusions of Law dated July 27, 1981, or the Memorandum of Intended Decision dated March 6, 1981 this Statement of Decision shall control.

B. DESCRIPTION AND CHARACTERISTICS OF 4100 REGULATIONS

1. Some of the characteristics of the 4100 Regulations are:

a. In determininng "fair return", the net operating income approach is used in contrast to the impermissible historic value approach employed in the previous set of regulations. The net operating income (NOI) equals the gross income less operating expenses (Section 4101(a)). Gross income equals the sum of gross rents, interest from rental deposits, income from miscellaneous facilities, and all other income received from use or occupancy of rental units. From this is subtracted uncollected rents due to vacancies and bad debts (Section 4101 (h)). Operating expenses include real property taxes, utility costs, management expenses, normal

repair and maintenance, owner performed labor, license and registration fees, and capital expenses (at a total cost of less than $100 per benefited unit, and amortized portion of capital expenses otherwise allowed by regulations). Operating expenses do not include avoidable expenses, mortgage principal and interest payments, penalties or fees incurred for violations, certain legal fees, depreciation, or any reimbursed expenses (Section 4101(c)).

b. It is presumed that NOI produced by the property in the base year of 1978 provided a fair return (Sections 4101(e) and 4102) (*Birkenfeld, supra* 165). This presumption may be rebutted by a finding by the Hearing Examiner in a manner set forth in Section 4103.

c. The Rent Control Board may permit individual petitioners to increase rents so that landlord's NOI will be increased at 40% of the increase in Consumers Price Index (CPI) over the base year 1978 (Section 4106). The CPI is that for all urban consumers for the Los Angeles, Long Beach, Anaheim Metropolitan Area (All Items) (Section 4103(f)). There is a limit on annual increases of not more than twice the Employment Cost Index (Section 4107).

d. An individual adjustment shall take into account any General Adjustment and is limited accordingly. General adjustments are to be calculated consistent with the 4100 Regulations (Sections 4108).

e. Section 4109 gives a landlord a choice to keep any individual adjustment given under previous regulations; or to relinquish previous rights and to petition under the 4100 Regulations.

2. The growth in profits is tied to the inflation rates. The typical landlord who purchased rental income property prior to the late 1970's probably financed the purchase of the property by a fixed rate loan (in California by a note secured by a deed of trust). For such typical landlord, the fixed rate of interest means no increase in original debt service costs

caused by inflation. In the late 1970's variable interest rate real property loans became increasingly more common.

3. This NOI approach to rent regulation is similar to that utilized in New Jersey and some Massachusetts communities. The method was approved in *Helmsley v. Borough of Fort Lee,* 78 N.J. 200, 394 A.2d 65 (1978), also holding that a "value based criterion" is practically unworkable in a rent controlled context (at p. 72). The principal objection to the value based criterion is that it is "practically unworkable" in a rent controlled context because of the alleged circularity effect. That is to say, if rents were uncontrolled values may spiral, so how can one calculate a fair rate of return upon uncontrolled spiralling prices? I do not share the extreme pessimism of the New Jersey Supreme Court; for as plaintiffs attempted to demonstrate in the trial of Phase II, it is possible to use base year (1978) actual market values, to interpolate for known years, then extrapolate for a limited number of future years utilizing certain facts and assumptions as to changes in CPI, changes in interest rates, etc. Where the court parts company with plaintiffs' conclusions and arguments, as will be expanded upon below, is that the extrapolation method may be valid in a court of law in this type of case only for a limited number of years. If extrapolation is attempted beyond a limited number of years, there are so many variables that the minimum test of proof by a preponderance of evidence required in the courts is not met . . . and the opinions of the expert witnesses, although buttressed by their economic mathematic calculations, become speculative.

Use of modern "mass appraisal" techniques may give more practicality to the return on market value criterion in testing constitutionality of rent control legislation, as well as providing a practical means of expediting calculation of rent adjustment by rent control boards and the petitioners seeking individual rent increases. But whether the NOI approach or a strict return on market value approach is used may not be the crucial constitutional test. As all sides agree, and this

court concurs, it is the result that counts with respect to the constitutional requirement of providing a fair return to landlords. (*Birkenfeld, supra* 165)

4. The evidence showed that a rent control plan should have the following characteristics, which are possessed by the NOI method:

a. The standard cannot be manipulated; standards which take into account current mortgage payments and/or purchase price can be manipulated through sales and refinancing. In testing whether a rent control plan is constitutional, the court need not consider individual financing arrangements. See *Zussman v. Rent Control Board of Brookline,* 371 Mass. 632, 359 N.E.2d 29, 33-34; and *Helmsley, supra* at 394 A.2d 80;

b. The NOI standard does not discriminate on the basis of "original" purchase price or financing arrangements, which this court found faulty in the old regulations in Phase I;

c. The analysis is simple to perform and is objective;

d. The standard is not "circular". For criticism of circularity see *Troy Hills v. Township Council,* 69 N.J. 604, 350 A.2d 34, 44 (1975);

e. The standard affords a growth in profit levels that is tied to the inflation rate.

f. The method encourages housing maintenance, because it permits landlords to pass through to tenants all operating expense increases regardless of profit levels.

C. CONSTITUTIONAL CONSIDERATIONS AS TO 4100 REGULATIONS

1. Phase II does not consider whether the Rent Control Board has or will handle individual rent control petitions in a constitutional manner. Since the 4100 Regulations only went into effect on October 19, 1981 during the midst of this hearing, the parties have not put into issue whether practical implementation of the 4100 Regulations has been

constitutional. This is a matter that may be left for future administrative mandamus proceedings, or a later possible plenary action.

2. This court does not consider whether rent control in the abstract may be a proper exercise of the police power. The California Supreme Court in *Birkenfeld v. City of Berkeley,* 17 Cal. 2d 129, 130 Cal. Rptr 465, 550 P.2d 1001 (1976) holds that rent control in general is a proper exercise of the municipal police power.

3. The parties have not tendered the issue as to whether imposition of the 4100 Regulations has constituted a "taking of property" as of the date of this decision, and the court has not found that any "taking" has occurred. In any individual administrative mandamus proceeding the question as to whether a "taking" has occurred as to that particular property would be a matter for that court to determine. See *San Diego Gas & Electric Co. v. City of San Diego,* (1981) 101 S.Ct. 1287.

4. This court may not and does not consider whether rent control regulation in the City of Santa Monica is wise or unwise. Such determination is a legitimate function of the legislative as opposed to the judicial function of government. *Birkenfeld* at 144 and 159.

5. The expert witnesses produced by all the parties agree, and this court concurs, that the return on investment of owners of rental property includes not only net operating income but also the reasonably anticipated increase in real property values as such has been anticipated in the last number of years, more particularly in 1978, the base year. However, this court is not bound to give to all owners all of their 1978 expectations. An ordinance otherwise properly within the police power does not become unconstitutional merely because, as a result of its operation, property does not achieve its maximum economic potential. *Maher v. City of New Orleans,* 516 F.2d 1051, 1065 (1975). Also as the evidence shows, reasonable expectations in 1978 have their "down" side as well as their "up" side.

6. As set forth in the Memorandum of Intended Decision, Par. C.8. dated March 6, 1981 (See *Birkenfeld* at 165, 169), a property owner whose property is regulated is entitled to a just and reasonable return upon his property. One definition of a just and reasonable return is a return which is commensurate with returns of investments in other enterprises having corresponding risks. That return should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain credit and to attract capital. The latter definition is tailored to fit public utilities which may or may not differ from rental housing properties (*FPC v. Hope Natural Gas, infra,* at 320 U.S 605.

7. Mere reduction in property values caused by regulation such as public utility rate-making or rent control regulation is not *ipso facto* unconstitutional. *Permian Baisin Area Rate Cases,* 390 U.S. 747, 769, 20 L.Ed 2d 312, 337 (1968); *FPC v. Hope Natural Gas,* 320 U.S. 591, 601, 88 L.Ed 333, 344 (1944); and *Troy Hills, supra* at 68 N.J. 617, 350 A.2d at 47.

8. Existing case law does not afford any precise standard as to what rate of return property owners in a regulated market are entitled to receive so that the court may employ a "litmus paper" test. Another way of putting the question is to ask, "What is the precise rate of return below which any system of rental regulation will be considered as affording an unconstitutional rate of return to property owners?" *Birkenfeld* does not furnish us with any such precise standard, and implies that the City of Berkeley rental ordinances fell substantially below any such precise standard. The New Jersey Supreme Court has wrestled with this problem in a series of recent cases cited in this Announcement but has failed to define a precise standard. However, the New Jersey Supreme Court has held that "The rate of return permitted need not be as high as prevailed in the industry prior to regulation nor as much as an investor might obtain by placing his capital elsewhere." *Hutton Park Gardens v. Town Council* 68 N.J. 543, 350 A.2d 1, 15 (1975). The parties in this case

were invited by the court to argue for their respective versions of a precise standard; and the court means no criticism of the parties, their counsel, or the learned expert witnesses to state that no precise standard has been proffered for the court's guidance.

The United States Supreme Court has rejected the older concept of substantive due process wherein it was assumed that there is some "fair" rate of return that persons are entitled to under the due process clauses of the 5th and 14th Amendments of the U.S. Constitution. Compare *Lochner v. New York*, 198 U.S. 45 (1904) more particularly Justice Holmes' dissent 75-76. See ***Birkenfeld, supra***, 154-156. However, in considering the "taking" clause of the 5th Amendment, (". . . nor shall private property be taken for public use, without just compensation"), courts must necessarily consider that if the rate of return permitted under a particular regulation falls below *some* low rate, that this constitutes a "taking" and/or an impermissible exercise of the police power. If we were in an economic era in which interest rates did not fluctuate and the rate of inflation were low or non-existent, it would be easier to propose such a minimum rate of return. Is it surprising that in these days of interest rates fluctuating substantially, and the rate of inflation undergoing similar fluctuations, it is much more difficult for appraisers, economists, lawyers, constitutional scholars and the courts to arrive at a precise standard? See *Matter of South Bronx Neighborhood Dev. Plan*, (Sup) 442 N.Y.S. 2d 869 (1981).

In the trial of Phase II, the expert witnesses for both sides employed in giving their testimony and making their economic mathematical computations at least the following variable factors: (a) fluctuation in interest rates; (b) fluctuation in consumer price indices; (c) anticipated holding periods for purchasers of rental housing properties (i.e., is the holding period 10 years, 20 years, or some greater period?); (d) ratio between the value of the land and the value of the improvements upon real property (i.e., is it 50%, 60% or

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9. The burden is upon plaintiffs to demonstrate or prove that the 4100 Regulations are unconstitutional. In Phase I, defendants urged that to hold the Rent Control Ordinance or the old regulations unconstitutional, plaintiffs had the burden of proving such assertion by "clear and convincing evidence." Plaintiffs then countered by saying that in California the burden of proof was only by a preponderance of evidence. I did not find it necessary in Phase I to decide what should be the precise burden of proof. (Memorandum of Intended Decision, March 6, 1981, Par. C.9). I do not find it necessary for me to articulate that precise burden of

proof in Phase II, for reasons set forth in Par. C.12. *infra*, See *Connolly v. Gen. Construction Co.*, 269 U.S. 385, 391 (1926); *U.S. v. Natl. Dairy Corp.*, 372 U.S. 29, 32-33 (1963) and *Parker v. Levy*, 417 U.S. 733, 757 (1974).

10. In Phase I, plaintiffs endeavored to show that there was a decline in residential rental property values in Santa Monica as a result of the passage of the Rent Control Amendment and its implementation. Defendants presented evidence to the contrary. Dr. Shulman, testifying for defendants, stated in both Phases I and II that residential income property values have not dropped in Santa Monica following the establishment of rent control in April 1979. He gives as some of his reasons for what economists anticipated normally would be a decline following imposition of rent controls (a) anticipation by the buyers and sellers that there will be an end to rent control by the legislative process or by court action (I held that this reason was impermissible in Phase I, and still so hold); (b) the land value is equal to or greater than the sum of the land and rent controlled building (or alternately and in a lesser sense, the ratio of land to improvements in Santa Monica residential properties is significantly higher than the ratios in other parts of Southern California). The testimony showed that there has been a great decline in the number of sales of residential rental properties in Santa Monica since April 1979 (as well as elsewhere), and that this decline in number of sales is due in large measure to the drying up of available financing caused by high interest rates.

Because of the decline in number of sales it is more difficult to adjudge as to whether the rent regulation has dried up the attraction and retention of capital. However, we do know that market values have not plummetted in Santa Monica, as might be expected since residential rental property owners have not placed their properties on the market at substantially reduced prices in order to "unload".

Defendants argue that new construction may be attracted into the Santa Monica market because it is exempt from

the provisions of rent control. We do not have evidence of this in Phase II, possibly because of the drop in new construction everywhere because of high interest rates, and also perhaps because of the possible shortage of available land in Santa Monica for new income residential construction.

We do not consider the economic effects of the restriction on alternate uses of the property (Section 1803(t) of the ordinance). This is reserved for Phase III.

11. The 4100 Regulations affect difference clauses of landlords in varying ways. Landlords who purchased properties in the 1960's and earlier may fare satisfactorily under the 4100 Regulations, so the evidence shows. Landlords who purchased in the early 1970's may not be happy with the 4100 Regulations, but they do not appear to be affected in the sense that the regulation is unconstitutional as to them. Plaintiffs urge that the 4100 Regulations are clearly unconstitutional when applied to those landlords who purchased in the late 1970's, because the latter purchased at high purchase prices in relation to the NOI in anticipation that a large measure of their eventual return on investment would be realized through continued appreciation in property values.

In the class of landlords who purchased in the late 1970's there is a sub-class who must have purchased in late 1978 or prior to April 1979 with the realization that the Rent Control Amendment would be on the ballot and had a good chance of passage. Such sub-class can be expected to have had discounted the chances for and against passage of the Rent Control Amendment in their offers which resulted in the purchase of their properties. We cannot say as to this sub-class that there has been a curtailment of an investment-backed reasonable expectation. *Graham v. Estuary Properties* (Fla., 1981) 399 So. 2d 1374. See *Flynn v. City of Cambridge*, (Mass., 1981) 418 N.E.2d 335, 339-340.

Those landlords purchasing in the 1970's who may be aggrieved by any denial of an individual petition under the

4100 Regulations may have redress to the courts through administrative mandamus proceedings. The reviewing court would then apply the constitutional test, based on fair market value as appropriately determined, to decide whether the results under Regulation 4100 in that particular case are unconstitutional. This court is ruling as to the generality of the constitutionality of the 4100 Regulations and not as to its effect upon every landlord. See *Birkenfeld* at 172.

But can we anticipate that land values even in Santa Monica will continue to appreciate in the 1980's, the 1990's and beyond at the same rate as in the 1970's? Asking the question in a more narrow and constitutional context, must we assume the same rate of appreciation, or even any appreciation at all?

12. The court finds that the plaintiffs have failed to meet their burden of proof that the 4100 Regulations are unconstitutional, even if we may employ the lower standard of burden of proof by a preponderance of the evidence. The quality of the evidence produced by all parties was excellent. Yet the testimony of experts on both sides failed to convince this court that the long-term results predicted by each set of respective experts would be more likely to occur than not to occur. Since plaintiffs have the burden of proof, whereas the defendants do not have such burden, the court's conclusion is that as of the time of this Announcement of Intended Decision the provisions of the 4100 Regulations are not unconstitutional under California or federal constitutional standards.

D. ARE THE 4100 REGULATIONS *ULTRA VIRES* UNDER THE RENT CONTROL AMENDMENT?

1. This presents two questions rather than one:

a. Is any portion of the 4100 Regulations facially in conflict with any other provision of the Rent Control Amendment?

b. If so, is the affected provision of the Rent Control Amendment constitutional?

2. Plaintiffs object to the fact that the Rent Control Board has come up with a new set of regulations that set forth in detail the factual and economic factors which the Board may consider in contrast to the general statements set forth in the Rent Control Amendment. Section 1803(t)(5) merely requires the Board to "Set rents at fair and equitable levels in order to achieve the intent of this Article." The delegation to the Board of setting forth the mode of achieving the purpose of the Amendment is sound administrative action. Kenneth Culp Davis in the authoritative American text: *Administrative Law Treatise* (West, 1958) Section 2.15, p. 149 aptly states this proposition:

> "The difficulty is that it is often affirmatively desirable for the legislative body to avoid either an intelligible principle or a clear delineation of the general policy, for the simple reason that many questions of basic policy may better be worked out by an agency that by a legislative body. For instance, the legislative body may say to the zoning board, in effect: 'What we want is a good system of zoning. We want you to protect both private interests and public interests. If you want to know what we mean by 'good' we are not prepared to tell you. Neither can we tell you how to accommodate private interests and public interests when they clash. That's your job. You can do it better than we can because we have to operate in wholesale fashion, whereas you can make concrete decisions in the light of all the facts and circumstances of particular cases.' For a legislative body to make this kind of statement is sometimes both good sense and good government. The legislative body itself is usually the best judge of the extent to which it should attempt to state an intelligible principle. When Congress decided to go no further in guiding

> the FCC than to say 'public convenience, interest, or necessity,' the Supreme Court wisely observed that 'this criterion is as concrete as the complicated factors for judgment in such a field of delegated authority permit . . .' " (*FCC v. Pottsville Broadcasting Co.*, 309 U.S. 134, 138, 84 L.Ed 656 (1940))

Davis cites (in his 1970 Supplement, Section 2.15) *In re Peterson* 51 Cal.2d 177, 331 P.2d 24, 77 ALR2d 1291 (1958), app. dismissed 360 U.S. 314, 3 L.Ed2d 1259 in support of his statement. Far more authoritative is *Birkenfeld* at 167-169, citing Davis.

Section 1803(g) provides that "The Board shall issue and follow such rules and regulations, including those which are contained in this Article, as will further the purposes of the Article." Thus the Rent Control Amendment in conjunction with its elaborate regulations follows the division of labor recommended by Professor Davis.

3. Section 1805(b)(3) provides in part that ". . . In adjusting rents under this subsection, the Board shall adopt a formula of general application . ." The 4100 Regulations track this section of the ordinance by providing in Section 4108 in part ". . .The Board is authorized to calculate and establish any General Adjustment consistent with this Subchapter."

4. With reference to Section 1805(e), in Phase I in the Memorandum of Intended Decision Par. E.2.a(3)(a), this court said "(a) That portion of the next to the last sentence reading ". . . .the speculative nature of the investment, whether or not the property was acquired or is held as a long term or short term investment. . ." is held to be unconstitutional and must be stricken if the ordinance as a whole is to be sustained. I further find that such stated portion is severable from the ordinance as a whole." The 4100 Regulations, more particularly Section 4101 are not in accord with Section 1805(e). This court in Phase II reiterates that the portion of Section 1805(e) quoted above is unconstitutional, yet is severable from the rest of the ordinance.

5. With further reference to Section 1805(e), in Phase I in the Memorandum of Intended Decision, Par. E.2.a.(3)(b)., this court said, "(b) That portion of the next to the last sentence reading ". . .and the landlords rate of return on investment", and the final sentence reading: "It is the intent of this Article that upward adjustments in rent be made only when demonstrated necessary to the landlord making a fair return on investment" may be construed as constitutional if the phrase "return on investment" in each instance is equated to mean "return on property". "Return on property" I take to mean the "return on fair market value of the property" This construction is in accordance with the California cases cited for this proposition above, and is done so as to construe as much of the ordinance as can be done as constitutional."

The 4100 Regulations do not use the "return on investment" approach utilized in the former 4040 Regulations. I reiterate that I construe that "return on investment" as used in the Rent Control Amendment is equated to mean "return on property." This is the test laid down in *Birkenfeld* at 165. See *U.S. v. General Motors*, 323 U.S. 373, 378, 89 L.Ed. 311, 318 (1945).

6. With reference to Section 1805(f) and (g), in Phase I in the Memorandum of Intended Decision, Par. E.2.a.(4), this court found such sub-paragraphs to be unconstitutional. However, it appears that the 4100 Regulations, more particularly Sections 4101, 4103, 4104, do not authorize the Board to consider as a factor for an individual rent increase the fact of negative cash flow either by reason of refinancing or at the time of acquisition. Therefore Section 1805(f) and (g) do not appear to be relevant to this comparison between the Rent Control Amendment and the 4100 Regulations.

7. For the reasons stated above, the 4100 Regulations are not *ultra vires*.

The clerk is ordered to mail forthwith to all parties who appeared at the trial a copy of this Statement of Decision.

DATED:

RICHARD A. LAVINE
Judge of the Superior Court

FOOTNOTES

[1]In the closely related subject of what constitutes a "taking" for inverse condemnation purposes, the courts and scholars have long considered and debated what are the proper tests to use in drawing the line between non-compensable police power actions, and those "takings" which are compensable. The economic effect upon the property owner is one of the considerations which has plagued those endeavoring to draw the line. The scholars have been unable to distinguish clearly the U.S. Supreme Court cases in this area. See:

a. *Griggs v. Allegheny County in Perspective: Thirty Years of Supreme Court Expropriation Law,* Allison Dunham in 1962 Sup. Ct. Rev. 63;

b. *Takings and the Police Power*, Joseph L. Sax in 74 Yale L.J. 36 (1964);

c. *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law,* Frank L. Michelman in 80 Harvard L.R. 1165 (1967);

d. *Taking or Damaging by Police Power: The Search for Inverse Condemnation Criteria,* Arvo Van Alstyne in 44 So.Cal. L.R. 1 (1970);

e. *A Policy Analysis of the Taking Problem,* 49 New York L.R. 165 (1974).

[2]"None of us really understand what's going on with all these numbers," Stockman confessed at one point. "You've got so many different budgets out and so many different baselines and such complexity now in the interactive parts of the budget between policy action and the economic environment and all the internal mysteries of the budget, and there are a lot of them. People are getting from A to B and it's not clear how they are getting there. It's not clear how we got there, and it's not clear how Jones is going to get there.

FILED
JUN 18 1982
JOHN J. CORCORAN, COUNTY CLERK
BY E. A. HARDISTER, DEPUTY

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

JAMES W. BAKER, et al.,
Plaintiffs,
v.
CITY OF SANTA MONICA, et al.,
Defendants.

SANTA MONICANS FOR RENTERS' RIGHTS, et al.,
Interveners.

JOHN J. STEIN, et al.,
Plaintiffs,
v.
CITY OF SANTA MONICA,
Defendant.

SANTA MONICANS FOR RENTERS' RIGHTS, et al.,
Interveners.

CASE NO. WEC 058763
(Transferred to South Central District)

CASE NO. WEC 059251
(Transferred to South Central District)

ANNOUNCEMENT OF INTENDED DECISION PHASE III
(Pursuant to Cal. Rules of Court) (232 and 232.5, Eff. Jan. 1, 1982)

APPENDIX-H

A. INTRODUCTION

1. Announcement of Intended Decision and Statement of Decision Phase III.

a. This Intended Decision is made pursuant to Rules 232 and 232.5 of the Judicial Council, as amended and effective January 1, 1982.

b. As stated in Announcement of Intended Decision, Phase II, Par. A.1, c., page 2, the court interprets the previous request for Findings in Phase I of this consolidated case to be equivalent to a request for a Statement of Decision. Hence any proposals as to content concerning this Statement of Decision in Phase III shall be made within ten (10) days of this Announcement of Intended Decision, issued on June 16, 1982. Pursuant to Rule 232(g), should any party require additional time to submit such proposal, such party is invited to request such additional time, and it would be the intention of this court to grant any reasonable request.

c. Thereafter it is the intention of this court to prepare and mail a proposed Statement of Decision within fifteen (15) days after expiration of the time for proposals, pursuant to Rule 232(c).

2. Proposals and Statement of Decision re Phase II.

a. Heretofore counsel for all parties requested concerning the Announcment of Intended Decision, Phase II, filed February 17, 1982 that the court extend the time for submission of proposals concerning the contents of Statement of Decision for Phase II until the issuance of this Intended Decision, Phase III, since the trial of Phase III followed soon after the Announcement of February 17, 1982. The court granted counsels' request and hence no proposals concerning contents of Statement of Decision for Phase II have been submitted as yet (Note: Defendants did submit such proposal, but withdrew same with the consent of the court).

b. Therefore any proposals as to contents of Statement of Decison as to Phase II shall be made within ten (10) days

of this Announcement of Intended Decision in Phase III, issued on June 16, 1982. Pursuant to Rule 232(g), should any party require additional time to submit such proposal, such party is invited to request such additional time, and it would be the intention of this court to grant any reasonable request.

3. Issue of Attorneys' Fees

a. One of the bifurcated and reserved issues of Phase III was the award of attorneys' fees, as requested by both sides.

b. The parties requested that the issue of attorneys' fees is further bifurcated and reserved until after the Announcment of Intended Decision in Phase III. The court acceded to this request and the issue of the request for attorneys' fees is bifurcated and reserved until a later time. The setting of such time, the scheduling of submissions of affidavits, memoranda, etc. will be settled at a setting conference to be announced by the court at a later time.

4. Preparation of Judgment

No proposed judgment is necessary at this time, as set forth in Rule 232.5, as the bifurcated issue of attorneys' fees is to be determined at a later time.

5. Nature and Effect of Phase III

a. The court refers to and incorporates specifically by reference Par. A.2. a.-f inclusive, pp.2-4, of the Intended Decision, Phase II filed February 17, 1982.

b. Trial of the issues of the constitutionality and legality of Section 1803(t) of the Rent Control Amendment came on regularly for trial on April 14, 15, and 16 in Department G of the South Central District, Richard A. Lavine, Judge presiding without a jury.

c. The court heard and considered the evidence, both oral and documentary introduced on behalf of the parties, and being fully advised makes this Announcement of Intended

Decision, Phase III. Pursuant to Rule 232.5, this Announcement of Intended Decision, Phase III is limited to issues not heretofore determined in Phases I and II. In addition, the issue of the request of the parties for attorneys' fees is bifurcated and reserved for hearing at a later time, as set forth in Par. A.3 *infra*.

d. Counsel for all parties have requested that except for the issue of attorneys' fees, reserved for later as described above, no additional issues be bifurcated or reserved for further proceedings. Therefore, this court does not intend to bifurcate or reserve any other issues. This supersedes the previous reservation of issues as set forth in the Findings of Fact and Conclusions of Law, Phase I, dated July 27, 1981, including issues set forth in Pretrial Statement and Order dated November 14, 1980. However, as a Court exercising equitable powers, the Court will and does reserve its jurisdiction to enforce its judgment.

e. Except to the extent inconsistent, the court incorporates herein its Memorandum of Intended Decision, Phase I, dated March 6, 1981, and Findings of Fact and Conclusions of Law, Phase I, dated July 27, 1981; and also the Intended Decision, Phase II filed February 17, 1982. In the event of a contradiction, discrepancy or ambiguity between the terms of this Announcement of Intended Decision, Phase III with the former documents, this Announcement of Intended Decision, Phase III, shall control.

B. NATURE OF PHASE III

Plaintiffs contend that Section 1803(t) of the Rent Control Amendment is unconstitutional and otherwise unlawful. Section 1803(t) provides:

"Any landlord who desires to remove a rental unit from the rental housing market by demolition, conversion, or other means is required to obtain a permit from the Board prior to such removal from the rental housing market in accordance with rules and regulations promulgated by the Board. In order

to approve such a permit, the Board is required to make each of the following findings.

"(1) That the controlled unit is not occupied by a person or family of very low income, low income or moderate income.

"(2) That the rent of the controlled rental units is not at a level affordable by a person or family of very low income, low income, or moderate income.

"(3) That the removal of the controlled rental unit will not adversely affect the supply of housing in the City of Santa Monica.

"(4) That the landlord cannot make a fair return on the investment by retaining the controlled rental unit.

[The above is referred to as a Category 1 removal permit]

"Notwithstanding the foregoing provisions of this subsection, the Board may approve such a permit:

(1) If the Board finds that the controlled rental unit is uninhabitable and is incapable of being made habitable in an economically feasible manner, [The above is referred to as a Category 2 removal permit], or

"If the permit is being sought so that the property may be developed with multifamily dwelling units and the permit applicant agrees as a condition of approval that the units will not be exempt from the provisions of this Article pursuant to Section 1801(c) and that at least fifteen (15) percent of the controlled rental units to be built on the site will be at rents affordable by persons of low income." [The above is referred to as a Category 3 removal permit].

C. THE FACTS

1. The expert witnesses produced by all the parties during Phase II agree, and this court concurs, that the return on investment of owners of residential rental property includes not only net operating income but also the reasonably anticipated increase in real property values as such has been anticipated in the last several years, more particularly in 1978,

the base year. In fact, the larger portion of return on investment is reflected in reasonably anticipated increase in real property values.

2. Testimony from one of defendants' expert witnesses, Dr. Shulman, with which this court concurs, in that for residential rental property in Santa Monica the average ratio of land to total value is conservatively between 60-70%; and that this ratio is high in comparison with ratios of land to total value in some other parts of California and elsewhere.

3. In Phase II both sides produced expert testimony concerning the expected total returns of owners of residential rental properties in Santa Monica. Evidence was produced that it can be reasonably expected that a purchaser of residential rental property anticipated holding such property for a ten year period; other testimony was that a reasonable holding period may be 20 years, or some other period. Whether the reasonably anticipated period of holding be ten years, twenty years, or some other time period, unless the landowner can reasonably expect to realize this increase in value by resale of the property at the end of the holding period, this so-called reasonably anticipated increase in value will be illusory. Plaintiffs contend that Section 1803(t) precludes the realization of this reasonably anticipated increase in value at the end of the holding period. The Rent Control Amendment in its wording is a permanent statute hence, insofar as this court is concerned, the court must and does consider that the Rent Control Amendment, and consequently its constituent Section 1803(t), will be in existence in its present form at the end of the holding period unless declared unconstitutional or void.

4. There are two economic reasons why landlords would remove rental units from the market:

a. The improvement has come to the end of its economic usefulness as an apartment building. While the building still has value and a use, there exists a more profitable use. In terms of land economics, land appraisal and nomenclature

in eminent domain cases, this means that the property has a "highest and best use" other than as a residential apartment house. This first case occurs whenever there is a more economically beneficial use of the improvement (such as for a condominium, office building or otherwise). Even though the owner may be receiving a fair return from the existing improvement, he may find it more beneficial to change the use of the improvements, e.g., conversion to condominiums; or to add commercial improvements (*Penn Central Transportation Co. v. City of New York* (1978) 438 U.S. 104; or to occupy it himself (*Flynn v. City of Cambridge* (1981, Mass) 418 N.E. 2d 335. The improvement may retain significant value as residential rental property, but has greater value for another use.

b. The improvement has come to the end of its economic life as an improvement to the land; i.e., the building no longer contributes any value whatsoever to the entire property. The testimony shows that before the rational owner will demolish the improvement, the improvement must have a negative value, since the cost of demolition must be calculated into the decision.

Plaintiffs do not contend that the owners are constitutionally entitled to put their improvements to the most economically beneficial use, as described in Sub-paragraph 4.a. above, for example, conversion to condominiums. Plaintiffs do contend that where the improvement has come to the end of its economic life as an improvement, as desribed in Sub-paragraph 4.b. above, that the owners cannot be compelled constitutionally to continue rental operation of improvements which do not contribute to the value of the land.

5. Plaintiffs contend that restrictions on removal under Section 1803(t) confront owners with a dilemma with serious economic and legal consequences, whichever horn of the dilemma is grasped. Under Section 1803(t), return to the owners of their ultimate reasonably anticipated investment depends upon eventual demolition and alternative use when

the buildings are worn out and uninhabitable. Yet under existing laws, the owner probably will not reach that state where the buildings are worn out and uninhabitable (allowing the owner to petition for a Category 2 removal permit). Physical deterioration and uninhabitability invite rent reductions under Section 1805, and expose the owner to civil liabilities. To avoid those civil liabilities, the rational owner may be obliged to undertake uneconomic repairs, which in turn would extend the building's life and defer any petition for a Category 2 removal permit.

Under state law, a warranty of habitability is implied in every rental agreement. (*Green v. Superior Court* (1974) 10 Cal. 3d 616). This warranty cannot be waived since it is applicable even though the condition were known to the tenant. (*Knight v. Hallsthammer* (1981) 29 Cal. 3d 46). A breach of the warranty of habitability would expose the owner to an action for emotional distress and punitive damages. (*Smith v. David* (1981) 120 Cal. App. 3d 101). Also the owner may be liable civilly for crimes of third parties. (*Kweitkowsky v. Superior Trading Co.* (1981) 123 Cal. App. 3d 324).

The court finds from the evidence and it appears facially in Section 1803(t) that few owners could comply with the requirements to obtain a Category 1 removal permit. In order to obtain a Category 2 removal permit, an owner must wait until his property has become uninhabitable. However, at a time when the property is approaching a state of uninhabitability, prior to the time the Board can issue a Category 2 removal permit, the owner is liable civilly as described above.

6. The court reiterates and reinterprets its finding as set forth in Par. C. 11. of the Intended Decision, Phase II filed February 17, 1982 that there is a sizeable class of owners, particularly those who purchased their properties in the 1970's, who are especially adversely affected by Section 1803(t). Although the court found that the 4100 Regulations are not facially unconstitutional merely because they may have an adverse affect on owners who acquired their

properties in the 1970's, this does not mean that Section 1803(t) is facially constitutional in its effect upon such class of owners.

In the Intended Decision, Phase II, this court ruled that those landlords purchasing in the 1970's who may be aggrieved by any denial of an individual petition *under the 4100 Regulations* may have redress to the courts through administrative mandamus preceedings; that this court is ruling only as to the generality of the constitutionality of the 4100 Regulations and not as to its effect upon every landlord (see *Birkenfeld* at p. 172); and the court merely found that plaintiffs have failed to meet their burden of proof that the 4100 Regulations are unconstitutional even employing the lower standard of burden of proof by a preponderance of the evidence. This court did not hold in Phase II, and does not hold in this Phase III, that the owners are necessarily receiving a fair rate of return on the value of their properties using the base year 1978, in respect to their total return on fair market value in 1978 (namely the two elements of (a) net operation income, and (b) reasonably anticipated increase in property value, realizable at end of holding period).

7. Plaintiffs contend that the question of removal restrictions must be considered together with the restrictions on rent under the 4100 Regulations; that no economically rational owner would demolish his property so long as he receives a fair return; and thus if the owner wishes to demolish his property, a fortiori, he is not receiving and does not anticipate a fair return from rental operation. The court has two problems with the complete validity of this contention. First, even if an owner has no constitutional right to be free from regulations which deny him merely a "fair return" (if it were possible to define precisely what is a "fair return"), however, he does have a right to be free from regulations which afford him no return or merely a confiscatory return. (See *Birkenfeld* p. 165). Second, even an economically rational owner might have other reasons for wishing to demolish his property. However, the court does believe from the evidence,

and so finds, that a large and substantial percentage of economically rational where in Santa Monica would not choose to demolish their property if they were realizing a net operating income that was not confiscatory.

8. None of the parties contend that up to the time of this Announcement of Intended Decision has there been a "taking of property", within the meaning of the Fifth Amendment to the United States Constitution or the California Constitution. The court finds that up to the time of this Announcement of Intended Decision, there has been no "taking of property" in this sense.

D. THE ISSUES

1. Plaintiffs contend that the issues are as follows:

a. Section 1803(t) is facially unconstitutional, since to obtain a Category 1 removal permit an owner must meet all the four conditions (1), (2), (3), and (4), as set forth in Paragraph B. *infra;* whereas satisfaction of the fourth condition alone; i.e., inability to make a fair return-should be constitutionally sufficient to permit withdrawal from the regulated residential rental market. For convenience we shall refer to this as the "*Brooks-Scanlon*" test, *Supra.*

b. That the criteria for granting a Category 1 removal permit are not severable from the remainder of Section 1803(t), and therefore the court should strike the entire Section 1803(t) as in conflict with the *Brooks-Scanlon* test.

c. That the owners have a constitutional and legal right to demolish their controlled rental properties on other grounds, whether or not they are making a fair total rate of return (i.e., non-confiscatory total rate of return) upon their property by reason of other constitutional and legal provisions including:

(1) Article I, Section 1 of the California Constitution which guarantees citizens the rights to acquire, possess, and protect property;

(2) California Civil Code Section 711, which provides that conditions restraining alienation when repugnant to the interest created are void; that since Section 711 is a general state law, Section 1803(t), being a city ordinance, is *ultra vires* and void.

d. That since Section 1803(t) must be stringent, plaintiffs are entitled to and are requesting the following relief:

(1) That the court grants to defendants a sixty (60) day stay to permit the City the opportunity, if it wishes, to draw up and enact new reasonable and constitutional requirements for an owner to obtain a removal permit;

(2) That the court issue a prohibitory injunction against the defendants preventing any and all demolitions of rental buildings;

(3) That the court issue a prohibitory injunction restraining the city from imposing any absolute ban upon evictions of tenants because of forthcoming demolition of rental buildings;

(4) That the court issue a prohibitory injunction restraining the City from imposing any special zoning requirements that may interfere with demolition of rental buildings.

2. In addition, plaintiffs request the court, on the basis of the pleadings and the Pretrial Statement and Order dated November 14, 1980, to set forth and announce in this Intended Decision, Phase III what constitutes the minimum total rate of return on residential properties in Santa Monica, upon the basis of 1978 values, in order to serve as a guide to the parties in all future proceedings involving rent control controversies under the Rent Control Amendment. Plaintiffs urge that this court has heard sufficient competent testimony from all sides, and has received sufficient memoranda of law during Phases I, II and III in order to make such adjudication; that the cost to any party, whether landlord or the defendants, in furnishing sufficient evidence to the courts in any

proceeding other than this plenary action, would be prohibitively costly and time-consuming not only to the parties but to the court system.

Plaintiffs urge in order to avoid the problem of circularity of valuation which exists in a controlled rental market that this court use only the component of the raw land in the residential property values in 1978 as the base; and that the constitutional minimum rate of return to be applied in relation to such raw land value be equivalent to say the rate of yield of public utility bonds.

E. DISCUSSION

1. Is Section 1803(t) facially unconstitutional under the Brooks-Scanlon tests? Yes.

Plaintiffs do not contend that removal of Section 1803(t) would *ipso facto* entitle them to convert a structure to condominium use. All plaintiffs contend, in this respect, is that they have a right to remove the structures. Nor do plaintiffs contend that the City defendant has no right to place any reasonable controls regulating removal. They concede that the City does have a right to impose reasonable controls regulating the removal process under the police power, provided such controls are not violative of the *Brooks-Scanlon* test.

The United States Supreme Court as well as the California Supreme Court have held that a regulated business such as a public utility cannot be compelled by the state to operate at a loss. The basis for this is that a compulsion to remain in business would be eqivalent to taking of property without just compensation, and therefore violative of the 14th Amendment. The seminal case is *Brooks-Scanlon Co. v. Railroad Comm'n of Louisiana* (1920) 251 U.S. 396 in which Brooks-Scanlon, a lumber company, was compelled by the state to operate its narrow-gauge railroad, despite the complaint by Brooks-Scanlon that it could not operate the railroad except at a loss. The Supreme Court held that the

state could not compel the railroad to remain in operation, and Justice Holmes stated at p. 399;

"A carrier cannot be compelled to carry on even a branch of business at a loss, much less the whole business of carriage....It is true that if a railroad continues to exercise the power conferred upon it by a charter from a state, the state may require it to fulfill an obligation imposed by the charter, even though fulfillment in that particular may cause a loss...But that special rule is far from throwing any doubt upon a general principle too well established to need further argument here. The plaintiff may be making money from its sawmill and lumber business, but it no more can be compelled to spend that than it can be compelled to spend any other money to maintain a railroad for the benefit of others who do not care to pay for it. If the plaintiff be taken to have granted to the public an interest in the use of the railroad, it may withdraw its grant by discontinuing the use when that use can be kept up only at a loss..."

In the later case of *Bullock v. State of Florida ex rel Railroad Comm'n of State of Florida* (1921) 254 U.S. 513, Justice, speaking for the court, held at p. 520:

"Apart from statute or express contract people who have put their money into a railroad are not bound to go on with it at a loss if there is no reasonable prospect of profitable operation in the future....No implied contract that they will do so can be elicited from the mere fact that they have accepted a charter from the State and have been allowed to exercise the power of eminent domain. Suppose that a railroad company should find that its road was a failure, it could not make the State a party to a proceeding for leave to stop, and whether the State would proceed would be for the State to decide. The only remedy of the company would be to stop, and that it would have a right to do without the consent of the State if the facts were as supposed."

The *Brooks-Scanlon* doctrine was followed by the Supreme Court of California in *Lyon & Hoag v. Railroad Commission* (1920) 183 Cal. 145, 147;

"The basis of the conclusion that the state cannot compel the operation of a public utility at a loss is that such an order is a taking of property without compensation and therefore violates the fourteenth amendment to the federal constitution. (*Brooks-Scanlon*) *Co. v. Railroad Com...*The theory on which the state exercises control over a public utility is that the property so used is thereby dedicated to a public use. The dedication is qualified, however, in that the *owner retains the right to receive a reasonable compensation for use of such property and for the service performed in the operation and maintenance thereof.*" (Emphasis added)

Although *Lyon* uses the phrase "operate at a loss", this is qualified by the later language that the utility is entitled to operate at a fair return. A more precise line of demarcation is declared in *Birkenfeld* at p. 165 which uses the test of a confiscatory rate of return. This means that an owner cannot be forced to remain in business when *unable* to receive a constitutional (that is a non-confiscatory) return.

Although the foregoing cases are speaking of a public utility, they would apply *a fortiori* to residential income property in which the owners at the time the buildings were constructed for residential income use made no dedication to the public and received no franchises from the state such as is true with a public utility. Previously this court has stated that for certain purposes residential income properties were not altogether analogous with public utilities; but certainly for purpose of considering whether a residential income property owner can be compelled to operate his business at a confiscatory rate of return, the residential income property owner does not possess less rights than a public utility. As Justice Holmes stated in *Brooks-Scanlon*, he simply may go out of business without the consent of the state.

This is consistent with the ruling in *Bowles v. Willingham* (1944) 321 U.S. 503 that wartime rent controls were mitigated by the statutory provision that: "...'Nothing in this Act shall be construed to require any person to sell any commodity

or to offer any accommodation for rent.' There is no requirement that the apartments in question be used for purposes which bring them under the Act."

The Rent Control Amendment itself uses this language in its fourth requirement: "(4) That the landlord cannot make a fair return on investment by retaining the controlled rental unit." Since Section 1803(t) employs three additional requirements besides requirement (4) in order to obtain a Category 1 removal permit, the section is facially unconstitutional under the *Brooks-Scanlon* test.

Defendants contend that if an owner is not realizing a fair total rate of return upon his property, he should petition the Rent Control Board for removal permit to establish his contention. There are three vices in this contention. (a) Section 1803(t) does not permit the granting of a removal permit upon a simple showing that the landlord is not realizing a fair total rate of return upon his property. (b) If a large proportion of landlords are compelled by Section 1803(t) to petition individually for removal permits, then Section 1803(t) is facially unconstitutional under the rule set forth in *Birkenfeld* pp. 169-173. (c) Any such petition would require an expensive and lengthy administrative hearing with expert witnesses for both the Rent Control Board and the owner. Since administrative mandamus review in the courts is conducted normally on the basis of the administrative record, any failure to make a complete record before the administrative agency would be risky. For these reasons individual hearings on these removal permit applications would be impractical, if not unconstitutional, as a deprivation of administrative due process.

2. Are the offending portions of Section 1803(t) severable so that the court should strike certain portions and leave intact other portions? No. However, Section 1803(t) is certainly severable from the other provisions of the Rent Control Amendment, and this court so holds.

When a portion of a statute containing a severability clause is declared to be uncontstitutional, the court has the following obligation under *In re Bell* (1942) 19 Cal. 2d 488, 498: "...Whether the remainder ...is complete in itself and would have been adopted by the legislative body had the latter foreseen the partial invalidation of the statute." (*In re Portnoy* (1942) 21 Cal. 2d 237, 242; *Santa Barbara School District v. Superior Court* (1975) 13 Cal. 3d 315, 331).

Section 1803(t) fails both of the severability tests mandated in *Bell supra.* Although the Rent Control Amendment has a severability clause (which this court utilized in its decision in Phase I). If we strike out, for example, the first three requirements for a Category 1 removal permit, the remainder which is left is not a coherent whole in its entirety.

The legislative history shows that there is no reason to believe the voters would have voted in favor of the Rent Control Amendment had the offending sections been omitted. The ballot analysis and arguments shows to the contrary that the voters were informed that Section 1803(t) provides: (*See Birkenfeld* pp. 173-174)

"A rental unit may not be demolished, converted, or otherwise removed from the housing market without a permit based on specific findings relative to the displacement of the City's supply of housing, particularly for people of low or moderate income."

There is another problem that the court would face if it tried to rewrite the section; namely, there are several alternatives as to what to include or what to exclude. Any rewriting of this section is a legislative task, not one for the court. For these reasons, the court considers that Section 1803(t) is not severable, and that the entire section must be stricken.

3. Do the owners have a constitutional and legal right to demolish their controlled rental properties on other grounds, whether or not they are making a fair total rate of return (i.e., non-confiscatory total rate of return) upon their property

by reason of other constitutional and legal provisions, including:

a. Article I, Section 1 of the California Constitution which guarantees citizens the rights to acquire, possess and protect property?

This form of attack upon the constitutionality of Section 1803(t) is broader than the *Brooks-Scanlon* test discussed *supra* and is similar to the issue raised in *Nash v. City of Santa Monica,* 2d Civ. No. 60079, presently pending before the Court of Appeal, Second District. However, in *Nash* the petitioner stipulated that he was earning, and would continue to earn, a fair return by retaining his property as controlled rental property. He simply argued that the right to go out of business is so fundamental that the City cannot take it away without payment of just compensation. The trial court agreed with petitioner's contention, and the case as so presented is now on appeal.

In *Nash* the trial court ruled that Section 1803(t) was unconstitutional on even broader grounds than urged here by plaintiffs, holding that the section was unconstitutional as violative of the interdiction against deprivation of property without due process of law contained in the 14th Amendment to the United States Constitution and the California Constitution (Article 1, Section 7(a)).[1]

An early California case expressed the rights contained in the then California Constitution in *Billings v. Hall* (1857) 7 Cal. 1,6; "Section first of Article I of the Constitution of California, declares that 'all men are by nature free and independent, and have certain inalienable rights, amongst which are those of enjoying and defending life and liberty, *acquiring possession, protecting property*, and pursuing and obtaining safety and happiness.' This principle is as old as the Magna Charta. It lies at the foundation of every constitutional government, and is necessary to the existence of civil liberty and free institutions." (Emphasis added). (*Miller v. McKenna* (1944) 23 Cal. 2d 774, 783.)

In the case at bar, plaintiffs' contentions and position are narrower than in *Nash*. Plaintifffs urge that the question of removal restrictions must be viewed in conjunction with restrictions on rent (as currently set forth in the 4100 Regulations). The court has previously referred to this as the "two-cork situation", in which one cork of the ordinance restricts the ability of the owners to raise rents, and the other cork places limitations upon the owners' ability to freely change the use or physical nature of the buildings,

Or b. California Civil Code Section 711, which provides that conditions restraining alienation when repugnant to the interest created are void; that since Section 711 is a general law whereas Section 1803(t) being a municpal ordinance in conflict, is *ultra vires* and void?

Civil Code Section 711, being a general law, renders *ultra vires* and supersedes any conflicting city ordinances. The courts have construed Section 711 to permit reasonable restraints and to invalidate unreasonable restraints (*Coast Bank v. Minderhout* (1964) 61 Cal. 2d 311).

In recent years the California Supreme Court, in light of the economic realities of these times, has applied Section 711 to strike down the due on sale clauses in mortgages. (*Dawn Investment v. Superior Court* (1982) 30 Cal 3d 695; *Wellenkamp v. Bank of America* (1978) 21 Cal. 3d 943). In *Wellenkamp*, the court used a two-fold analysis at pp. 948-949:

"[A] direct relationship exists between the *justification* for enforcement of a particular restraint on the one hand, and the *quantum of restraint*, the actual practical effect upon alienation which would result from enforcement on the other. Thus, the greater the quantum of restraint that results from enforcement of a given clause, the greater must be the justification for that enforcement." (Emphasis in text).

Plaintiffs urge that although a large proportion of Santa Monica owners earn minimal returns from rental operation of their properties, they are "virtually unable" to withdraw

from the regulated market because of Section 1803(t); that since the Rent Control Ordinance, and its implementing regulations, preclude adequate returns from either rental operation or alternative use, the owners cannot sell without absorbing very substantial losses; that those with substantial mortgage obligations could easily forfeit their entire equity; and that from an economic standpoint this is as great if not greater a restraint upon alienation as due on sale mortgages in times of economic stresses.

No matter how meritorious plaintiffs' contentions may be as discussed in Paragraph 3 a. and b. above, it is not necessary for this court to determine the constitutionality or legality of Section 1803(t) on these grounds. It is sufficient to hold that the section is stricken as being violative of the *Brooks-Scanlon* test.

4. What should be the nature of the relief granted to plaintiffs in this Phase III?

a. Should the court give declaratory relief and adjudge that Section 1803(t) is unconstitutional and is stricken from the other portions of the Rent Control Amendment (not otherwise unconstitutional)? And should the court grant to defendants a sixty (60) day stay in order to permit the City the opportunity, if it wishes, to draw up and enact new reasonable and constitutional requirements for an owner to obtain a removal permit? Yes, to both questions.

Since the court has declined the task of re-writing Section 1803(t), or its equivalent, in a constitutional form, discussed *supra*, the City is given the opportunity, if it wishes, to draw up a new ordinance and enact same, within a period of sixty (60) days following the filing of this Intended Decision, Phase III, so that the City would not be without any restrictions upon removal of residential income properties during this period. The court specifically reserves jurisdiction to consider any later issues that may be raised by plaintiffs that any new ordinance is not in conformity with the court's ruling in Phase III.

b. Should the court issue a prohibitory injunction against the defendants preventing any and all demolitions of rental buildings? No.

c. Should the court issue a prohibitory injunction restraining the City from imposing any absolute ban upon evictions of tenants because of forthcoming demolition of rental buildings? No.

d. Should the court issue a prohibitory injunction restraining the City from imposing any special zoning requirements that may interfere with demolition of rental buildings? No.

The court does not wish to impose any chilling effect upon the City in the proper exercise of its role in enacting any new ordinance it may choose to enact, in conformity with this decision in Phase III. Also the court should not anticipate in advance that the City will enact any ordinances that are in conflict with the holdings of this court. Hence, any such injunctions are not necessary at this time.

5. Should the court set forth in this Intended Decision what constitutes the minimum total rate of return on residential properties in Santa Monica, upon the basis of 1978 values, in order to serve as a guide to the parties in all future proceedings involving rent control controversies under the Rent Control Amendment? No.

The court recognizes the practical reasons which may justify plaintiffs' request. Certainly this court has had the benefit of hearing from well-qualified expert witnesses presented by both sides, together with presentation of well-defined issues, arguments and memoranda of counsel which would not be present in administrative mandamus proceedings because of practical limitations of expense to all parties, together with limitations on available court time. However, the court doubts whether it is feasible in these economically changing times for the court to "draw a line", ... below the line being "confiscation", and above the line being a "constitutionally permissible return." The New Jersey Supreme Court has

wrestled with this problem for years, as discussed previously, to no avail. The California Supreme Court in *Birkenfeld* did not attempt the task. Even if it were possible in simpler times for a court to set forth a standard, in these times of economic ups and downs a court could not feasibly set a standard that could reasonably be anticipated to remain valid for the next several years. The variables which would have to be taken into account by a court in setting any such standard may include among others: (a) the present interest rate, and rate to be reasonably anticipated in the future; (b) the present Consumer's Price Index, and the increases or decreases to be reasonably anticipated in the future; (c) the holding periods reasonably to be anticipated for structures of varying ages since construction, and varying types of construction. If any governmental body in California were to undertake this complex task, it would best be the California Legislature, and not the courts...together with the task of keeping its standard current in light of changing economic conditions.

The clerk is ordered to mail forthwith to all parties who appeared at the trial a copy of this Announcement of Intended Decision (Rule 232 (a)).

DATED: June 16, 1982

Richard A. Lavine

RICHARD A. LAVINE
Judge of the Superior Court

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[1]The concept of substantive due process as applied to controls on land use is not yet dead; in fact it is being revived in recent years. See *San Diego Gas & Electric Co. v. City of San Diego* (1981) 450 U.S. 621, 67 L.Ed. 2d 531, 101 S.Ct. 1287, in footnote 14 of the dissent at page 649 (four members of the court joined in this dissent, and Justice Rehnquist agreed in principle therewith). See Vested Rights, Estoppel, and the Land Development Process, 29 Hastings L.J. (1978) 633 (n. 26), 663-664.

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SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

JAMES W. BAKER, et al., Plaintiffs, v. CITY OF SANTA MONICA, et al., Defendants.	CASE NO. WEC 058763 (Transferred to South Central) (District) STATEMENT OF DECISION PHASE III
SANTA MONICANS FOR RENTERS' RIGHTS, et al., Interveners.	
JOHN J. STEIN, et al., Plaintiffs, v. CITY OF SANTA MONICA, Defendant.	CASE NO. WEC 059251 (Transferred to South Central) (District)

APPENDIX-I

SANTA MONICANS FOR RENTERS' RIGHTS, et al.,
Interveners.

A. INTRODUCTION

1. Announcement of Intended Decision and Statement of Decision Phase III.

a. Pursuant to Rules 232 and 232.5 of the Judicial Council, as amended and effective January 1, 1982, the Court issued an Announcement of Intended Decision, filed on June 18, 1982.

b. Having received and read counsel's proposals and objections thereto, and good cause appearing therefor, the court issues this Statement of Decision, Phase III.

2. Issue of Attorneys' Fees.

a. One of the bifurcated and reserved issues of Phase III was the award of attorneys' fees, as requested by both sides.

b. The parties requested that the issue of attorneys' fees be further bifurcated and reserved until after the Announcement of Intended Decision in Phase III. The court acceded to this request and the issues of the request for attorneys' fees is bifurcated, severed and reserved until a later time.

3. Nature and Effect of Phase III.

a. The court refers to and incorporates specifically by reference Par. A.2. a-f inclusive, pp. 2-4, of the Intended Decision, Phase II filed February 17, 1982.

b. Trial of the issues of the constitutionality and legality of Section 1803(t) of the Rent Control Amendment came on regularly for trial on April 14, 15, and 16 in Department G of the South Central District, Richard A. Lavine, Judge presiding without a jury.

c. The court heard and considered the evidence, both oral and documentary introduced on behalf of the parties,

and being fully advised makes this Statement of Decision, Phase III. Pursuant to Rule 232.5, this Statement of Decision, Phase III, is limited to issues not heretofore determined in Phases I and II. In addition, the issues of the request of the parties for attorneys' fees is bifurcated, severed and reserved for hearing at a later time, as set forth in Par. A.2 *infra.*

d. Counsel for all parties have requested that except for the issues of attorneys' fees, reserved for later as described above, no additional issues be bifurcated or reserved for further proceedings. Therefore, this court does not intend to bifurcate or reserve any other issues. This supersedes the previous reservation of issues as set forth in the Findings of Fact and Conclusions of Law, Phase I, dated July 27, 1981, including issues set forth in Pretrial Statement and Order dated November 14, 1980. However, as a Court exercising equitable powers, the Court will and does reserve its jurisdiction to enforce its judgment.

e. Except to the extent inconsistent, the court incorporates herein its Memorandum of Intended Decision, Phase I, dated March 6, 1981, and Findings of Fact and Conclusions of Law, Phase I, dated July 27, 1981; the Announcement of Intended Decision, Phase II, filed February 17, 1982, the Announcement of Intended Decision, Phase III, filed June 18, 1982, and the Statement of Decision, Phase II. In the event of a contradiction, discrepancy or ambiguity between the terms of this Statement of Decision, Phase III, with the former documents, this Statement of Decision, Phase III, shall control.

B. NATURE OF PHASE III

Plaintiffs contend that Section 1803(t) of the Rent Control Amendment is unconstitutional and otherwise unlawful. Section 1803(t) provides:

"Any landlord who desires to remove a rental unit from the rental housing market by demolition, conversion, or other means is required to obtain a permit from the Board prior

to such removal from the rental housing market in accordance with rules and regulations promulgated by the Board. In order to approve such a permit, the Board is required to make each of the following findings.

"(1) That the controlled unit is not occupied by a person or family of very low income, low income or moderate income.

"(2) That the rent of the controlled rental units is not at a level affordable by a person or family of very low income, low income, or moderate income.

"(3) That the removal of the controlled rental unit will not adversely affect the supply of housing in the City of Santa Monica.

"(4) That the landlord cannot make a fair return on the investment by retaining the controlled rental unit.

[The above is referred to as a Category 1 removal permit]

"Notwithstanding the foregoing provisions of this subsection, the Board may approve such a permit:

(1) If the Board finds that the controlled rental unit is uninhabitable and is incapable of being made habitable in an economically feasible manner, [The above is referred to as a Category 2 removal permit], or

"If the permit is being sought so that the property may be developed with multifamily dwelling units and the permit applicant agrees as a condition of approval that the units will not be exempt from the provisions of this Article pursuant to Section 1801(c) and that at least fifteen (15) percent of the controlled rental units to be built on the site will be at rents affordable by persons of low income. [The above is referred to as a Category 3 removal permit].

C. THE FACTS

1. The expert witnesses produced by all the parties during Phase II agree, and this court concurs, that the return on investment of owners of residential rental property includes not only net operating income but also the reasonably

anticipated increase in real property values as such has been anticipated in the last several years, more particularly in 1978, the base year. In fact, the larger portion of return on investment is reflected in reasonably anticipated increase in real property values.

2. Testimony from one of defendants' expert witnesses, Dr. Shulman, with which this court concurs, is that for residental property in Santa Monica as of 1978 the average ratio of land to total value is conservatively between 60-70%; and that this ratio for 1978 is high in comparison with ratios of land to total value in some other parts of California and elsewhere.

3. In Phase II both sides produced expert testimony concerning the expected total returns of owners of residential rental properties in Santa Monica. Evidence was produced that it can be reasonably expected that a purchaser of residential rental property anticipates holding such property for a ten year period; other testimony was that a reasonable holding period may be 20 years, or some other period. Whether the reasonably anticipated period of holding be ten years, twenty years, or some other time period, unless the landowner can reasonably expect to realize this increase in value by resale of the property at the end of the holding period, this so-called reasonably anticipated increase in value will be illusory. Plaintiffs contend that Section 1803(t) precludes the realization of this reasonably anticipated increase in value at the end of the holding period. The Rent Control Amendment in its wording is a permanent statute hence, insofar as this court is concerned, the court must and does consider that the Rent Control Amendment, and consequently its constituent Section 1803(t), will be in existence in its present form at the end of the holding period unless declared unconstitutional or void.

4. There are two economic reasons why landlords would remove rental units from the market: a. The improvement has come to the end of its economic usefulness as an apartment building. While the building still has value and a use, there

exists a more profitable use. In terms of land economics, land appraisal and nomenclature in eminent domain eases, this means that the property has a "highest and best use" other than as a residential apartment house. This first case occurs whenever there is a more economically beneficial use of the improvement (such as for a condominium, office building or otherwise). Even though the owner may be receiving a fair return from the existing improvement, he may find it more beneficial to change the use of the improvements, *e.g.*, conversion to condominiums; or to add commercial improvements (*Penn Central Transportation Co. v. City of New York* (1978) 438 U.S. 104) or to occupy it himself (*Flynn v. City of Cambridge* (1981, Mass) 418 N.E. 2d 335). The improvement may retain significant value as residential property, but has greater value for another use.

b. The improvement has come to the end of its economic life as an improvement to the land; *i.e.*, the building no longer contributes any value whatsoever to the entire property. The testimony shows that before the rational owner will demolish the improvement, the improvement must have a negative value, since the cost of demolition must be calculated into the decision.

Plaintiffs do not contend that the owners are constitutionally entitled to put their improvements to the most economically beneficial use, as described in Sub-paragraph 4.a. above, for example, conversion to condominiums. Plaintiffs do content that where the improvement has come to the end of its economic life as an improvement, as described in Sub-paragraph 4.b. above, that the owners cannot be compelled constitutionally to continue rental operation of improvements which do not contribute to the value of the land.

5. Plaintiffs contend that restrictions on removal under Section 1803(t) confront owners with a dilemma with serious economic and legal consequences, whichever horn of the dilemma is grasped. Under Section 1803(t), return to the owners of their ultimate reasonably anticipated investment

depends upon eventual demolition and alternative use when the buildings are worn out and uninhabitable. Yet under existing law, the owner probably will not reach that state where the buildings are worn out and uninhabitable (allowing the owner to petition for a Category 2 removal permit). Physical deterioration and uninhabitability invite rent reductions under Section 1805, and expose the owner to civil liabilities. To avoid those civil liabilities, the rational owner may be obliged to undertake uneconomic repairs, which in turn would extend the building's life and defer any petition for a Category 2 removal permit.

Under state law, a warranty of habitability is implied in every rental agreement. (*Green v. Superior Court* (1974) 10 Cal. 3d 616). This warranty cannot be waived since it is applicable even though the condition were known to the tenant. (*Knight v. Hallsthammar* (1981) 29 Cal. 3d 46). A breach of the warranty of habitability would expose the owner to an action for emotional distress and punitive damages. (*Smith v. David* (1981) 120 Cal. App. 3d 101). Also the owner may be liable civilly for crimes of third parties. (*Kweitkowsky v. Superior Trading Co.* (1981) 123 Cal. App. 3d 324).

The court finds from the evidence and it appears facially in Section 1803(t) that few owners could comply with the requirements to obtain a Category 1 removal permit. In order to obtain a Category 2 removal permit, an owner must wait until his property has become uninhabitable. However, at a time when the property is approaching a state of uninhabitability, prior to the time the Board can issue a Category 2 removal permit, the owner is liable civilly as described above.

6. The court reiterates and reinterprets its findings as set forth in Par. C. 11. of the Intended Decision, Phase II filed February 17, 1982 that there is a sizeable class of owners, particularly those who purchased their properties in the 1970's, who are especially adversely affected by Section 1803(t). Although the court found that the 4100 Regulations are not facially unconstitutional merely because they may

have an adverse affect on owners who acquired their properties in the 1970's, this does not mean that Section 1803(t) is facially constitutional in its effect upon such class of owners.

In the Intended Decision, Phase II, this court ruled that those landlords purchasing in the 1970's who may be aggrieved by any denial of an individual petition *under the 4100 Regulations* may have redress to the courts through administrative mandamus proceedings; that this court is ruling only as to the generality of the constitutionality of the 4100 Regulations and not as to its effect upon every landlord (*see Birkenfeld* at p. 172); and the court merely found that plaintiffs have failed to meet their burden of proof that the 4100 Regulations are unconstitutional even employing the lower standard of burden of proof by a preponderance of the evidence. This court did not hold in Phase II, and does not hold in this Phase III, that the owners are necessarily receiving a fair rate of return on the value of their properties using the base year 1978, in respect to their total return on fair market value in 1978 (namely the two elements of (a) net operation income, and (b) reasonably anticipated increase in property value, realizable at end of holding period).

7. Plaintiffs contend that the question of removal restrictions must be considered together with the restrictions on rent under the 4100 Regulations; that no economically rational owner would demolish his property so long as he receives a fair return; and thus if the owner wishes to demolish his property, a fortiori, he is not receiving and does not anticipate a fair return from rental operation. The court has two problems with the complete validity of this contention. First, even if an owner has no constitutional right to be free from regulations which deny him merely a "fair return" (if it were possible to define precisely what is a "fair return"), however, he does have a right to be free from regulations which afford him no return or merely a confiscatory return. (*See Birkenfeld* p. 165). Second, even an economically rational owner might have other reasons for wishing to demolish his

property. However, the court does believe from the evidence, and so finds, that a large and substantial percentage of economically rational owners in Santa Monica would not choose to demolish their property if they were realizing a net operating income that was not confiscatory.

8. The parties have not tendered the issue as to whether the imposition of the 4100 Regulations has constituted a "taking of property" as of the date of this decision and the court has not found that any "taking" has occurred. In any individual administrative mandamus proceeding the question as to whether a "taking" has occurred as to that particular property would be a matter for that court to determine.*See San Diego Gas & Electric Co. v. City of San Diego* (1981) 101 S.Ct. 1287.

D. THE ISSUES

1. Plaintiffs contend that the issues are as follows:

a. Section 1803(t) is facially unconstitutional, since to obtain a Category 1 removal permit an owner must meet all the four conditions (1), (2), (3) and (4), as set forth in Paragraph B. *infra;* whereas satisfaction of the fourth condition alone; *i.e.*, inability to make fair return should be constitutionally sufficient to permit withdrawal from the regulated residential rental market. For convenience we shall refer to this as the "*Brooks-Scanlon*" test, *supra.*

b. That the criteria for granting a Category I removal permit are not severable from the remainder of Section 1803(t), and therefore the court should strike the entire Section 1803(t) as in conflict with the *Brooks-Scanlon* test.

c. That the owners have a constitutional and legal right to demolish their controlled rental properties on other grounds, whether or not they are making a fair total rate of return (*i.e.*, non-confiscatory total rate of return) upon their property by reason of other constitutional and legal provisions including:

(1) Article I, Section 1 of the California Constitution which guarantees citizens the rights to acquire, possess, and protect property;

(2) California Civil Code Section 711, which provides that conditions restraining alienation when repugnant to the interest created are void; that since Section 711 is a general state law, Section 1803(t), being a city ordinance, is *ultra vires* and void.

d. That since Section 1803(t) must be stricken, plaintiffs are entitled to and are requesting the following relief:

(1) That the court grants to defendants a sixty (60) day stay to permit the City the opportunity, if it wishes, to draw up and enact new reasonable and constitutional requirements for an owner to obtain a removal permit;

(2) That the court issue a prohibitory injunction against the defendants preventing any and all demolitions of rental buildings;

(3) That the court issue a prohibitory injunction restraining the city from imposing any absolute ban upon evictions of tenants because of forthcoming demolition of rental buildings;

(4) That the court issue a prohibitory injunction restraining the City from imposing any special zoning requirements that may interfere with demolition of rental buildings.

2. In addition, plaintiffs request the court, on the basis of the pleadings and the Pretrial Statement and Order dated November 14, 1980, to set forth and announce in this Decision, Phase III what constitutes the minimum total rate of return on residential properties in Santa Monica, upon the basis of 1978 values, in order to serve as a guide to the parties in all future proceedings involving rent control controversies under the Rent Control Amendment. Plaintiffs urge that this court has heard sufficient competent testimony from all sides, and has received sufficient memoranda of law during Phases I, II and III in order to make such adjudication; that the

cost to any party, whether landlord or the defendants, in furnishing sufficient evidence to the courts in any proceeding other than this plenary action, would be prohibitively costly and time-consuming not only to the parties but to the court system.

Plaintiffs urge in order to avoid the problem of circularity of valuation which exists in a controlled rental market that this court use only the component of the raw land in the residential property values in 1978 as the base; and that the constitutional minimum rate of return to be applied in relation to such raw land value be equivalent to say the rate of yield of public utility bonds.

E. DISCUSSION

1. Is Section 1803(t) facially unconstitutional under the *Brooks-Scanlon* test? Yes.

Plaintiffs do not content that removal of Section 1803(t) would *ipso facto* entitle them to convert a structure to condominium use. All plaintiffs contend, in this respect, is that they have a right to remove the structures. Nor do plaintiffs contend that the City defendant has no right to place any reasonable controls regulating removal. They concede that the City does have a right to impose reasonable controls regulating the removal process under the police power, provided such controls are not violative of the *Brooks-Scanlon* test.

The United States Supreme Court as well as the California Supreme Court have held that a regulated business such as a public utility cannot be compelled by the state to operate at a loss. The basis for this is that a compulsion to remain in business would be equivalent to taking of property without just compensation, and therefore violative of the 14th Amendment. The seminal case is *Brooks-Scanlon Co. v. Railroad Comm'n of Louisiana* (1920) 251 U.S. 396 in which Brooks-Scanlon, a lumber company, was compelled by the state to operate its narrow-gauge railroad, despite the complaint by Brooks-Scanlon that it could not operate the

railroad except at a loss. The Supreme Court held that the state could not compel the railroad to remain in operation, and Justice Holmes stated at p. 399;

"A carrier cannot be compelled to carry on even a branch of business at a loss, much less the whole business of carriage....It is true that if a railroad continues to exercise the power conferred upon it by a charter from a state, the state may require it to fulfill an obligation imposed by the charter, even though fulfillment in that particular may cause a loss...But that special rule is far from throwing any doubt upon a general principle too well established to need further argument here. The plaintiff may be making money from its sawmill and lumber business, but it no more can be compelled to spend that than it can be compelled to spend any other money to maintain a railroad for the benefit of others who do not care to pay for it. If the plaintiff be taken to have granted to the public an interest in the use of the railroad, it may withdraw its grant by discontinuing the use when that use can be kept up only at a loss..."

In the later case of *Bullock v. State of Florida ex rel Railroad Comm'n of State of Florida* (1921) 254 U.S. 513, Justice Holmes, speaking for the court, held at p. 520:

"Apart from statute or express contract people who have put their money into a railroad are not bound to go on with it at a loss if there is no reasonable prospect of profitable operation in the future...No implied contract that they will do so can be elicited from the mere fact that they have accepted a charter from the State and have been allowed to exercise the power of eminent domain. Suppose that a railroad company should find that the road was a failure, it could not make the State a party to a proceeding for leave to stop, and whether the State would proceed would be for the State to decide. The only remedy of the company would be to stop, and that it would have a right to do without the consent of the State if the facts were as supposed."

The *Brooks-Scanlon* doctrine was followed by the Supreme Court of California in *Lyon & Hoag v. Railroad Commission* (1920) 183 Cal. 145, 147;

"The basis of the conclusion that the state cannot compel the operation of a public utility at a loss is that such an order is a taking of property without compensation and therefore violates the fourteenth amendment to the federal constitution. *Brooks-Scanlon Co. v. Railroad Com...*The theory on which the state exercises control over a public utility is that the property so used is thereby dedicated to a public use. The dedication is qualified, however, in that the *owner retains the right to receive a reasonable compensation for use of such property and for the service performed in the operation and maintenance thereof.*" (Emphasis added.)

Although *Lyon* uses the phrase "operate at a loss", this is qualified by the later language that the utility is entitled to operate at a fair return. A more precise line of demarcation is declared in *Birkenfeld* at p. 165 which uses the test of a confiscatory rate of return. This means that an owner cannot be forced to remain in business when *unable* to receive a constitutional (that is a non-confiscatory) return.

Although the foregoing cases are speaking of a public utility, they would apply *a fortiori* to residential income property in which the owners at the time the buildings were constructed for residential income use made no dedication to the public and received no franchises from the state such as is true with a public utility. Previously this court has stated that for certain purposes residential income properties were not altogether analogous with public utilities; but certainly for purpose of considering whether a residential income property owner can be compelled to operate his business at a confiscatory rate of return, the residential income property owner does not possess less rights than a public utility. As Justice Holmes stated in *Brooks-Scanlon*, he simply may go out of business without the consent of the state.

This is consistent with the ruling in *Bowles v. Willingham* (1944) 321 U.S. 503 that wartime rent controls were mitigated by the statutory provision that: "...'Nothing in this Act shall be construed to require any person to sell any commodity or to offer any accomodation for rent.' There is no requirement that the apartments in question be used for purposes which bring them under the Act."

The Rent Control Amendment itself uses this language in its fourth requirement: "(4) That the landlord cannot make a fair return on investment by retaining the controlled rental unit." Since Section 1803(t) employs three additional requirements besides requirement (4) in order to obtain a Category I removal permit, the section is facially unconstitutional under the *Brooks-Scanlon* test.

Defendants contend that if an owner is not realizing a fair total rate of return upon his property, he should petition the Rent Control Board for removal permit to establish his contention. There are three vices in this contention. (a) Section 1803(t) does not permit the granting of a removal permit upon a simple showing that the landlord is not realizing a fair total rate of return upon his property. (b) If a large proportion of landlords are compelled by Section 1803(t) to petition individually for removal permits, then Section 1803(t) is facially unconstitutional under the rule set forth in *Birkenfeld* pp. 169-173. (c) Any such petition would require an expensive and lengthy administrative hearing with expert witnesses for both the Rent Control Board and the owner. Since administrative mandamus review in the courts is conducted normally on the basis of the administrative record, any failure to make a complete record before the administrative agency would be risky. For these reasons individual hearings on these removal permit applications would be impractical, if not unconstitutional, as a deprivation of adminstrative due process.

2. Are the offending portions of Section 1803(t) severable so that the court should strike certain portions and leave intact other portions? No. However, Section 1803(t) is

certainly severable from the other provisions of the Rent Control Amendment, and this court so holds.

When a portion of a statute containing a severability clause is declared to be unconstitutional, the court has the following obligation under *In re Bell* (1942) 19 Cal. 2d 488, 498: "...Whether the remainder... is complete in itself and would have been adopted by the legislative body had the latter foreseen the partial invalidation of the statute." (*In re Portnoy* (1942) 21 Cal. 2d 237, 242; *Santa Barbara School District v. Superior Court* (1975) 13 Cal. 3d 315, 331).

Section 1803(t) fails both of the severability tests mandated in *Bell, supra*. Although the Rent Control Amendment has a severability clause (which this court utilizes in its decision in Phase I), if we strike out, for example, the first three requirements for a Category 1 removal permit, the remainder which is left is not a coherent whole in its entirety.

The legislative history shows that there is no reason to believe the voters would have voted in favor of the Rent Control Amendment had the offending sections been omitted. The ballot analysis and arguments shows to the contrary that the voters were informed that Section 1803(t) provides: (*See Birkenfeld* pp. 173-174)

"A rental unit may not be demolished, converted, or otherwise removed from the housing market without a permit based on specific findings relative to the displacement of the City's supply of housing, particularly for people of low or moderate income."

There is another problem that the court would face if it tried to rewrite the section; namely, there are several alternatives as to what to include or what to exclude. Any rewriting of this section is a legislative task, not one for the court. For these reasons, the court considers that Section 1803(t) is not severable, and that the entire section must be stricken.

3. Do the owners have a constitutional and legal right to demolish their controlled rental properties on other grounds,

whether or not they are making a fair total rate of return (*i.e.*, non-confiscatory total rate of return) upon their property by reason of other constitutional and legal provisions, including:

a. Article I, Section 1 of the California Constitution which guarantees citizens the rights to acquire, possess and protect property?

This form of attack upon the constitutionality of Section 1803(t) is broader than the *Brooks-Scanlon* test discussed *supra* and is similar to the issue raised in *Nash v. City of Santa Monica*, 2d Civ. No. 60079, presently pending before the Court of Appeal, Second District. However, in *Nash* the petitioner stipulated that he was earning, and would continue to earn, a fair return by retaining his property as controlled rental property. He simply argued that the right to go out of business is so fundamental that the City cannot take it away. The trial court agreed with petitioner's contention, and the case as so presented is now on appeal.

In *Nash* the trial court ruled that Section 1803(t) was unconstitutional on even broader grounds than urged here by plaintiffs, holuing that the section was unconstitutional as violative of the interdiction against deprivation of property without due process of law contained in the 14th Amendment of the United States Constitution and the California Constitution (Article 1, Section 7(a)).[1]

An early California case expressed the rights contained in the then California Constitution in *Billings v. Hall* (1857) 7 Cal. 1, 6; "Section first of Article I of the Constitution of California, declares that 'all men are by nature free and independent, and have certain inalienable rights, amongst which are those of enjoying and defending life and liberty, *acquiring possession, protecting property*, and pursuing and obtaining safety and happiness.' This principle is as old as the Magna Charta. It lies at the foundation of every constitutional government, and is necessary to the existence of civil liberty and free institutions." (Emphasis added.) (*Miller v. McKenna* (1944) 23 Cal. 2d 774, 783.)

In the case at bar, plaintiffs' contentions and position are narrower than in *Nash*. Plaintiffs urge that the question of removal restrictions must be viewed in conjunction with restrictions on rent (as currently set forth in the 4100 Regulations). The court has previously referred to this as the "two-cork situation", in which one cork of the ordinance restricts the ability of the owners to raise rents, and the other cork places limitations upon the owners' ability to freely change the use or physical nature of the buildings,

Or b. California Civil Code Section 711, which provides that conditions restraining alienation when repugnant to the interest created are void; that since Section 711 is a general law whereas Section 1803(t) being a municipal ordinance in conflict, is *ultra vires* and void?

Civil Code Section 711, being a general law, renders *ultra vires* and supersedes any conflicting city ordinances. The courts have construed Section 711 to permit reasonable restraints and to invalidate unreasonable restraints (*Coast Bank v. Minderhout* (1964) 61 Cal. 2d 311).

In recent years the California Supreme Court, in light of the economic realities of these times, has applied Section 711 to strike down the due on sale clauses in mortgages. (*Dawn Investment v. Superior Court* (1982) 30 Cal. 3d 695; *Wellenkamp v. Bank of America* (1978) 21 Cal. 3d 943). In *Wellennkamp,* the court used a two-fold analysis at pp 948-949: "[A] direct relationship exists between the *justification* for enforcement of a particular restraint on the one hand, and the *quantum of restraint,* the actual practical effect upon alienation which would result form enforcement on the other. Thus, the greater the quantum of restraint that results form enforcement of a given clause, the greater must be the justification for that enforcement." (Emphasis in text).

Plaintiffs urge that although a large proportion of Santa Monica owners earn minimal returns from rental operation of their properties, they are "virtually unable" to withdraw from the regulated market because of Section 1803(t); that

since the Rent Control Ordinance, and its implementing regulations, preclude adequate returns from either rental operation or alternative use, the owners cannot sell without absorbing very substantial losses; that those with substantial mortgage obligations could easily forfeit their entire equity; and that from an economic standpoint this is as great if not greater a restraint upon alienation as due on sale mortgages in times of economic stress.

No matter how meritorious plaintiffs' contentions may be as discussed in Paragraph 3 a. and b. above, it is not necessary for this court to determine the constitutionality or legality of Section 1803(t) on these grounds. It is sufficient to hold that the section is stricken as being violative of the *Brooks-Scanlon* test.

---

[1]The concept of substantive due process as applied to controls on land use is not yet dead; in fact it is being revived in recent years. *See San Diego Gas & Electric Co. v. City of San Diego* (1981) 450 U.S. 621, 67 L.Ed. 2d 531, 101 S.Ct. 1287, in footnote 14 of the dissent at page 649 (four members of the court joined in this dissent, and Justice Rehnquist agreed in principle therewith). *See* Vested Rights, Estoppel, and the Land Development Process, 29 Hastings L.J. (1978) 633 (n. 26), 663-664.

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SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

JAMES W. BAKER, et al.,
Plaintiffs,
vs.
CITY OF SANTA MONICA, et al.,
Defendants.

SANTA MONICANS FOR RENTERS' RIGHTS, et al.,
Interveners.

JOHN J. STEIN, et al.,
Plaintiffs,
vs.
CITY OF SANTA MONICA,
Defendant.

SANTA MONICANS FOR RENTERS' RIGHTS, et al.,
Interveners.

CASE NO. WE C 058763
(Transferred to Central District)

NO. WE C 059251
(Transferred to Central District)

ANNOUNCEMENT OF INTENDED DECISION
PHASE III A
(Pursuant to California Rules of Court 232 and 232.5, Eff. January 1, 1982)

APPENDIX-J

A. INTRODUCTION

1. Announcement of Intended Decision, Phase III A.

a. This Announcement of Intended Decision is made pursuant to Rules 232 and 232.5 of the Judicial Council, as amended and effective January 1, 1982.

b. As stated in Announcement of Intended Decision, Phases II and III, the court interprets the previous Request for Findings in Phase I of this consolidated case to be equivalent to a request for a Statement of Decision. Hence, any proposals as to content concerning a Statement of Decision in Phase III A shall be made within ten (10) days of this Announcement of Intended Decision, issued on _____. Pursuant to Rule 232(g), should any party require additional time to submit such proposals, such party is invited to request such additional time, and it would be the intention of this court to grant any reasonable requests.

c. Thereafter it is the intention of this court to prepare and mail a proposed Statement of Decision within fifteen (15) days after expiration of the time for proposals, pursuant to Rule 232(c).

2. Issue of Attorneys' Fees

a. One of the bifuracted and reserved issues of Phase III was the award of attorneys fees.

b. The parties requested that the issue of attorneys' fees be further bifurcated and reserved until after the Announcement of Intended Decision in Phase III. The court acceded to this request and the issue of the request for attorneys' fees was additionally bifurcated and reserved until a later time.

c. Briefs have been submitted in part, a motion for a protective order made, and further proceedings are anticipated in the future. Until this Announcement of Intended Decision is made in Phase III A, the entire matter of attorneys fees is not ripe for determination by this court. Hence, the issue of attorneys' fees continues to be bifurcated and reserved until a later time.

3. Preparation of Judgment

a. Since the issue of attorneys' fees is regarded by statute and case authority as being essentially a "cost" issue, there is no reason why a judment cannot be prepared, signed and filed at the present time, following the resolution of Statement of Decision.

b. Following the resolution of Statement of Decision in this Phase III A, counsel for plaintiffs are directed to prepare a proposed judgment, to submit same to opposing counsel for approval as to form and substance, and to lodge such proposed judgment with the court.

4. Nature and Effect of Phase III A

a. The court refers to and incorporates specifically by reference from Statement of Decision Phase III, Paragraphs C. 1., 2., and 3.

b. Trial of the issues of the constitutionality and legality of the Replacement Ordinance of the City of Santa Monica came on regularly for trial in Department 2D of the Central District (the consolidated cases having been transferred from the South Central District to the Central District), Richard A. Lavine, Judge presiding without a jury.

c. The court heard and considered the evidence, both oral and documentary introduced on behalf of the parties, and being fully advised makes this Announcement of Intended Decision, Phase III A. Pursuant to Rule 232.5, this Announcement of Intended Decision, Phase III A is limited to issues not heretofore determined in Phases I, II and III. In addition the issue of the request of the parties for attorneys' fees is bifurcated and reserved for hearing at a later time, as set forth in Par. A.2. *infra.*

d. Although except for the issue of attorneys fees, no other issues have been bifurcated or reserved until a later time. However, as a court exercising equitable powers, the court will and does reserve its jurisdiction to enforce its judgment.

e. Except to the extent inconsistent, the court incorporates herein its Memorandum of Intended Decision, Phase I, dated March 6, 1981, and Findings of Fact and Conclusions of Law, Phase I, dated July 27, 1981; and also the Statement of Decision, Phase II, filed October 29, 1982; and also the Statement of Decision, Phase III, filed October 29, 1982. In the event of a contradiction, discrepancy or ambiguity between the terms of this Announcement of Intended Decision, Phase III A, with the former documents, this Announcement of Intended Decision, Phase III A, shall control.

B. PURPOSE OF PHASE III A.

1. In Par. E. 4.a. of the Announcement of Intended Decision Phase III (as well as in Par. E. 4.a. of the Statement of Decision, Phase III), the court granted the City of Santa Monica, an opportunity, if it wished, to draw up a new ordinance and enact same, so that the City would not be without any restrictions upon removal of residential income properties.

2. Accordingly, the City adopted Ordinance 1255 and related Rent Board regulations (collectively referred to here as the "Replacement Ordinance"). The key provisions of these regulations, together with the linkage with the former regulations, declared unconstitutional in Phase III, are as follows:

(a) Category A.

The Board shall grant a removal permit if it finds that the landlord is unable to collect the current Maximum Allowable Rent (MAR) on the unit.

(b) Category B.

The Board shall grant a removal permit if it finds that the current MAR for the unit does not provide a fair return and that the landlord cannot rent the unit at that rent necessary to provide the landlord with a fair return.

[Categories A and B may be considered as replacements for the former Cateory 1].

(c) Category C

The Board shall grant a removal permit if it finds that the controlled rental unit is uninhabitable and cannot be made habitable in an economically feasible manner. [Category C is almost identical to the former Category 2].

(d) Category D.

The Board may grant a removal permit if the permit is being sought so that the propery may be developed with multifamily rental dwelling units and the permit applicant agrees as a condition of approval that the units will not be exempt from the provision of Santa Monica City Charter section 1801(c) and that at least fifteen percent of the controlled rental units to be built will be at rents affordable by persons of low incomes by deed restriction. [Category D is identical to the former Category 3].

(e) Multiple Unit Rental Structures.

The Board shall grant a Cateory A, B, or C removal permit with respect to a rental unit if it finds that the MAR's of individual units which the landlord owns on the same property cannot be adjusted so as to enable the landlord to collect an overall fair return and further finds that the landlord has otherwise complied with these regulations.

3. Accordingly this Phase III A is concerned with the validity of the Replacement Ordinance.

C. THE ISSUES

1. Are Ordinance 1255 and the related Rent Board regulations (the Replacemelnt Ordinance) facially unconstitutional?

2. Are Ordinance 1255 and the related Rent Board regulations (the Replacement Ordinance) invalid, i.e., *ultra vires* as being in conflict with the California statewide policies enunciated in Chapter 1207 of California Stats., 1979 (uncodified) in part as follows:

> The Legislature further finds and declares that:
>
> (a) It is a matter of urgent public necessity that the housing supply shortfall in California be eliminated.
>
> (b) It is essential to address and remedy the basic causes of the problem rather than its symptoms, and that these causes include the following:
>
> (1) Insufficient availability of land suitable and capable of being developed for the purpose of housing.
>
> (2) Increases in the time and uncertainty for completion of housing development and construction, largely attributable to processing requirements, which significantly increase the cost of the completed housing and delay its availability to the public.
>
> (3) Increases in costs relating to community objectives and services, placed directly upon new residential construction.
>
> (4) Government statutes, regulations, and policies which are insensitive to housing needs, or which individually or collectively tend to frustrate the production of housing.
>
> (c) For all these and other reasons, a chaotic housing marketplace now exists in California, in which enough housing cannot be produced in some areas at any price to meet the demand while in others, costs and uncertainties combine to make essential new and existing housing stock unattractive to capital investment.

3. Are the regulations, more particularly Category B, unconstitutional as denying procedural due process to owners under *Birkenfeld*?

4. Sub-issues are that defendants contend that this court lacks jurisdiction:

a. To consider the California General Laws namely Chapter 1207, 1979, as the question of this statute was not raised n the complaint.

b. To consider (a) the interrelation of the landlords' net operating income under the allowable maximum rents and (b) the effect of prohibitions against demolition, since the question of the constitutionality of Regulation 4100 maximum rents was allegedly adjudicated previously in Phase II.

5. If Ordinance 1255 and the related Rent Board regulations are invalid as being facially unconstitutional or invalid as *ultra vires*, should this court grant an injunction?

6. If an injunction should be granted, what should be the terms of the injunction?

D. DISCUSSION

1. Are Ordinance 1255 and the related Rent Board regulations facially unconstitutional? Yes.

In Phase II as well as Phase III the expert witnesses for both sides testified that the total income of the landlord consisted principally of both the net operating income and the capital gain upon the sale of the rental property. The court ruled in Phase III that the owners are entitled to withdraw from the regulated market when unable to earn a constitutional return, i.e., a non-confiscatory return upon the value of the property. Defendants have not contended in Phases II, III, or III A that net operating income alone under Regulation 4100 allows a constitutional return to owners. Defendants' experts testified that the combination of net operating income together with eventual capital gain would yield a non-confiscatory return.

For purpose of simplification of issues, simplification of proof, and as not to confuse the issues of maximum rents and controls on demolition, this court bifurcated the issues, so that only the issue of the constitutionality of the maximum rents was adjudicated in Phase II. The issue of the constitutionality of the controls on demolition was reserved for Phase III. This mode of adjudication avoided, to a large extent, confusion between these two issues. Otherwise it would have been difficult, if not impossible, to have sorted out the problems affecting rent control itself; for the court would have had to consider simultaneously fluctuations in two variables namely (a) the effects of maximum rents and (b) the effects of demolition control.[1] As a result of this bifurcation of issues, the court found that plaintiffs had failed to meet their burden of proof of demonstrating that rent control was unconstitutional.

The Replacement Ordinance and the associated regulations contain no provision allowing owners to withdraw from the regulated market when unable to earn a constitutional return. Since the constitutionality of Regulation 4100 rents depends upon the ability of an owner to eventually demolish his building (according to defendants' arguments in Phases II and III), the City of Santa Monica cannot simply refuse a removal permit to an owner in the fashion set forth in the Replacement Ordinance. Defendants' logic is circular. If owners may be restricted to lower rents than the market would

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[1]Much of the evidence in Phases I and II were presented with the use of mathematical economics. Hence, it is appropriate to refer to the method used in partial differential caluculus to deal with changes in several variables. *Glenn James:* "The Tree of Mathematics" (Digest Press, Pacoima, Ca., 1957) states in sec. 92, pp. 103-104: "THE PARTIAL DERIVATIVE. To find the change in a function of several variables due to changes in all of the variables we combine the changes due to each of them while the others are being held constant. For example, consider that z depends on x and y, written z 'equals' f(x,y). Now by fixing y we find the instantaneous rate of change of z with respect to x by merely finding dz/dx."

bring because eventually they will receive removal permits, then the City cannot refuse to grant removal permits because the owners can still collect the lower rents.

The City cannot have it both ways. If the City had been unable in Phase II to show the likelihood that the owners may eventually realize a capital gain at the time of demolition, then this court would have declared Regulation 4100 unconstitutional in view of the low net operating income permitted to owners in contrast to returns on other types of investment. Since the court has already refused to declare Regulation 4100 facially unconstitutional in Phase II, it is unnecessary for the court to reconsider the constitutionality of rent controls, and the court declines to do so at this time. However, the court must presently consider the constitutionality of demolition controls, and finds upon the basis of all of the economic evidence offered in the case that the existence of such demolition controls does not provide a constitutional, i.e., non-confiscatory return to the large majority of the owners of controlled rental housing in Santa Monica.

In Par. C.11, page 17 of Statement of Decision Phase II, filed October 29, 1982, the court recognized that although there may be a small class of landlords who are constitutionally aggrieved by the 4100 Regulations, members of such small class are relegated to their remedy in administrative mandamus. This court finds that the class of landlords who would be constitutionally aggrieved by the combination of Regulation 4100 maximum rents together with the restrictions on demolition are substantially greater than the small class referred to in Phase II. This larger class identified in Phases III and III A may constitute more than 50% of the total number of units subject to regulation in Santa Monica (see Par. C.6. of Announcement of Decision Phase III, filed October 29, 1982).

In Phase III this court sought to strike down section 1803(t) on the narrowest of constitutional grounds. This is consistent with the rule and practice of American courts to avoid deciding questions of constitutionality unless it is necessary

to do so in rendering a decision. With regard to removal of controls there are at least three degrees of constitutionality that may be considered. The first and narrowest degree is whether the statute meets the *Brooks Scanlon* test. The court struck down section 1803(t) in Phase III as falling short of meeting the *Brooks Scanlon* test. The second degree is whether the statute fails to yield a constitutional, i.e., non-confiscatory return under *Birkenfeld*. In this Phase III A the court finds that the controls on demolition fail to yield a constitutional, i.e., non-confiscatory return under *Birkenfeld*, similar to this court's holding in Phase I regarding the prior rent controls. The third degree is whether any controls on demolition are constitutional, regardless of whether the owner is making a constitutional return from the combination of net operating income plus capital gain upon demolition. The latter test was employed in the *Nash* decision. In view of the decision of this court above, it is unnecessary to consider whether the Replacement Ordinance meets the test employed in *Nash*, hence, this court declines to consider the third and latter test.

2. Are Ordinance 1255 and the related Rent Board regulations invalid, i.e., *ultra vires* as being in conflict with the California statewide policies set forth in Chapter 1207 of California Stats., 1979? Yes.

It is interesting to note that the City of Los Angeles and the County of Los Angeles which are the closest governmental entities to the City of Santa Monica do not purport to control demolition in the sweeping fashion of Santa Monica Replacement Ordinance and its predecessor section 1803(t). It has been stated in evidence that the City of Santa Monica's pattern of rent control is the most stringent in the nation. Neither of these two facts necessarily renders the Replacement Ordinance invalid. However, in considering whether the Replacement Ordinance is invalid as being against enunciated state policy, it is significant that other government entities have not chosen sweeping restrictions on demolition.

The effect of the Santa Monica Replacement Ordinance is to freeze land use and preclude the construction of new housing. The evidence shows that there is little undeveloped land in Santa Monica, so that new housing effectively can be provided only if existing structures are demolished and new buildings erected containing more units than in the demolished structure. The Replacement Ordinance effectively blocks this construction of buildings with more units than presently exist. Hence, it is contrary to state policy as enunciated by the legislature. See concurring opinion of Judge Marshall in *The Pines v. City of Santa Monica*, 29 Cal.3d 656, 664-665 (1981). Since no subordinate governmental unit can pass an ordinance which is contrary to state policy, the Replacement Ordinance is invalid for this additional reason.

3. Are the regulations, more particularly Category B, unconstitutional as denying procedural due process to owners under *Birkenfeld*? Yes.

In *Birkenfeld* the California Supreme Court ruled the Berkeley rent control ordinance unconstitutional as it would have required each owner to file a petition for each rent increase sought and to undergo an administrative hearing to establish the validity of each petitioner's case. Category B provides in part: "The Board shall grant a removal permit if it finds that the current MAR for the unit does not provide a fair return. . . ."

This means that any owner who contends that he or she is not realizing a fair return from a particular unit must assume the onerous burden of proof that the unit does not yield a total return, i.e., return from net operating income and future anticipated capital gain upon demolition to satisfy his or her constitutional right to a fair return. We have previously shown the circularity of this reasoning, but there are additional flaws. There is no finding by this court that the Regulation 4100 rents are constitutional, but merely a ruling that plaintiffs had failed in their burden of proof to demonstrate that Regulation 4100 rents are unconstitutional. Consider the burden cast by this regulation upon each owner

as to each unit. Plaintiffs contend they have spent in excess of $400,000 in attorneys fees in Phases I, II, and III and of the case at bar. This court has spent many weeks of court time and has heard eminent economic experts on these involved economic questions.

In order for any petitioner for a Category B removal permit to make an administrative record sufficient to prove his or her constitutional position for reviewing courts upon administrative mandamus review, such owner would have to make a showing involving many days of hearing, and much expenditure of attorneys and experts fees, for each unit he or she owns. I find that the placing of such a burden would deprive each owner of administrative due process. Because of the time, expense and expertise required, owners could not effectively file and establish these petitions.

The evidence produced by defendants in the factual part of Phase III A failed to refute the fact that owners could not effectively or practically meet the enormous burden that the City of Santa Monica would cast upon them in seeking to obtain a Category B removal permit. Since the class of owners who would seek such Category B relief is such a large class, as discussed previously, the Replacement Ordinance fails for the additional reason of depriving the owners of administrative due process, which as a minimum should afford a speedy, convenient adminstrative hearing at a cost not inconsistent with the value of the right to demolish which the owner is seeking to assert.

4.a. Does this court lack subject matter jurisdiction to consider the effect of California General Laws Chapter 1207, 1979, because this statute was not specifically mentioned in the complaint? No, this court has subject matter jurisdiction.

The issues raised by the complaint and the Pretrial Order are broad enough to include the invalidity of the Replacement Ordinance on other than strictly constitutional grounds. Moreover, the issue of the effect of Chapter 1207, 1979 was raised by plaintiffs as early as the argument in Phase III.

The issue of *ultra vires* was argued to this court. The court specifically permitted defendants, if they wished, to reopen the evidentiary aspect of Phase III A to present any additional evidence, but defendants did not request this court to reopen the evidentiary aspect as to any issues. California pleading is broad enough, especially with a Pretrial Order whose effect is to supplement the pleadings, to allow any party to raise in argument any and all relevant statutes that support litigant's position. Defendants have not been surprised or prejudiced by the raising of this new statutory argument in Phases III or III A.

4.b. Does this court lack jurisdiction in Phase III A for this court to consider (a) the interrelation of the owners' net operating income under the allowable maximum rents, and (b) the effect of prohibitions against demolition, although the question of the constitutionality of Regulation 4100 maximum rents was allegedly adjudicated in Phase II previously?

No, this court possesses jurisdiction to consider the relationship.

Although defendants cite no statute, rules of court or case authority on this point, defendants argue that plaintiffs (and this court) may no longer consider the interrelation of (a) the net operating income which owners receive and (b) the effect of this upon demolition control, because of the Announcement of Decision made in Phase II. The court does not agree with defendants' arguments because of the following reasons:

(1) This court must now consider economically and legally the interrelation of the two components of total return to an owner, namely net operating income and probable capital gain upon sale.

It is ultimately fallacious to consider one without the other, although for convenience we emphasized rent control in Phases I and II.[2]

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[2]See Footnote 1, *supra*.

(2) This court did not hold that Regulation 4100 rents were per se constitutional. All this court held in Phase II is that plaintiffs had failed to meet their burden of proof to show the unconstitutionality of rent controls alone except possibly as to a small class of owners. In Phases I and II, the court did not consider the effect of prohibitions on demolition, for reasons of bifurcation as discussed previously.

(3) Although this court has not changed its position as expressed in Phase II, it would have the power to do so if it chooses. Until there is a final judgment, this court could, if it chooses, change any ruling previously made. California Rules of Court 232.5 provides for a series of Statements of Decision for purpose of convenience at trial and on appeal, although these may by changed prior to judgment.

5. Should this court grant an injunction? Yes.

At the conclusion of Phase III, this court granted leave to the City of Santa Monica to draft such ordinances which it believed to be proper to meet the police power needs of the City against uncontrolled demolition, consistent with previous decisions. As set forth above, the City of Santa Monica passed an ordinance which is not in accord with the prior decisions of this court in Phases I, II and especially III. Therefore this court has no choice but to grant an injunction against the City of Santa Monica and the Rent Control Board.

6. What should be the nature of the injunction?

The City of Santa Monica and the Rent Control Board should be enjoined from regulating or prohibiting, directly or indirectly, demolitions of residential rental housing except as follows:

a. To enact such regulations as are necessary to ensure that the physical demolition of the property will not be hazardous to the public health or safety;

b. To enact regulations to ensure that existing tenants have time to find alternate housing, such time not to exceed 120 days;

c. To enact a regulation providing that if, within 45 days of the filing of an application for a demolition permit, the City makes a good faith finding based upon clear and convicing evidentiary testimony that economic considerations are not a substantial factor in the owners' intentions in filing for an application for a demolition permit, the City may then, and only then, reject such application; and,

d. The injunction may be reconsidered upon the request of the defendants in the event that defendant Rent Control Board adopts new regulations for determining general and individual rent adjustments.

The reasoning of the court in promulgating 6.c. above is that under the narrow test of *Brooks Scanlon*, and the arguments of plaintiffs, a rational owner will only demolish his property for valid economic reasons. Under the narrow rule of *Brooks Scanlon* all that is therein protected is the right of the owner to withdraw from the market if he believes he cannot make a fair return. Hence, this court does not go any farther in this respect in this decision.

The reasoning of the court as to 6.d is as follows:

This court has considered the analogy that there are two spouts and two corks on the steam kettle of the entire plan of rent control in Santa Monica. One cork restrains owners from "releasing steam" by raising current rents. The second cork prevents owners from realizing capital gains by demolishing the property and putting it to a higher economic use. If the City of Santa Monica chooses to release pressure under the first cork, then it would be logical to permit the City to tighten the cork on the second spout which controls demolition.

The clerk is ordered to mail forthwith to all parties who appeared at the trial a copy of this Announcement of Intended Decision.

Dated: [illegible]

RICHARD A. LAVINE

RICHARD A, LAVINE
Judge of the Superior Court

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FILED
JUL 14 1983
JOHN J. CORCORAN, COUNTY CLERK
BY E. SCHWARTZ, DEPUTY

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

JAMES W. BAKER, an individual, ALLAN R. FREEMAN, an individual, and LILI PLUKAS, an individual, Plaintiffs, v. CITY OF SANTA MONICA, a California charter city; JAMES CONN, DENNIS ZANE, CHRISTINE E. REED, KENNETH EDWARDS, DOLORES PRESS, DAVID EPSTEIN, and WILLIAM JENNINGS, each in his or her official capacity as a member of the City Council of the City of	CASE NO. WEC 058763 (Transferred to Central District) JUDGMENT

Santa Monica; SANTA MONICA RENT CONTROL BORAD, a California public entity; DAVID FINKEL, NEIL A. STONE, LESLIE LAMBERT, SUSAN PACKER DAVIS, and WAYNE BAUER, each in his or her capacity as a Commissioner of the Santa Monica Rent Control Board,

Defendants.

SANTA MONICANS FOR RENTERS' RIGHTS, an unincorporated association; SANTA MONICA FAIR HOUSING ALLIEANCE, a corporation,

Intervenors.

CASE NO. WEC 059251
(Transferred to Central District)

JOHN J. STEIN, JEANNE LOCKE, an individual, and H. HUDSON DECRAY, an individual,

Plaintiffs,

v.

CITY OF SANTA MONICA, a California charter city,

Defendant.

SANTA MONICANS FOR RENTERS' RIGHTS, an unincorporated association; and SANTA MONICA FAIR HOUSING ALLIANCE, a corporation,

Intervenors.

This case and the issues herein, having been bifurcated into four parts with each part having come on regularly for trial before the Honorable Richard A. Lavine, Judge Presiding, sitting without jury, Plaintiffs appearing by Stephen L. Jones and George Kimball of Latham & Watkins, Defendant City of Santa Monica and its City Council appearing by Stephen Shane Stark and Karl M. Manheim, Defendant Santa Monica Rent Control Board appearing by David Pettit and Stephen Wiman and Intervenors appearing by Robert M. Myers and Ronald Rouda, the Court having considered the evidence and arguments, oral and documentary, having been presented by all parties and good cause appearing therefor;

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that:

1. Plaintiffs, and each of them, have standing to bring this action both as taxpayers seeking to prevent a waste of public funds and as owners of controlled rental properties seeking a judicial declaration as to their rights, duties and responsibilities under Article XVIII of the Charter of the City of Santa Monica (hereinafter the "Rent Control Amendment"), on its face and as it has been interpreted and applied by the Santa Monica Rent Control Board.

2. Rent control is in general a proper exercise of the municipal police power, but only so long as its provisions do not necessarily lower rents more than could reasonably be required for the measure's stated purpose and its provisions provide landlords with just and reasonable returns on the value of their properties.

3. Deciding whether a rent regulation permits a just and reasonable return requires consideration of the value of the rental property, the reasonable expense of operating the property, the income, the rate of return on the value of the property actually permitted by the rent regulations and the minimum rate of return which would be just and reasonable for that property.

4. "Investment", as defined by Regulation 4040 of the Rent Control Board and otherwise applied by the Board (herein referred to as historic cash investment), is constitutionally impermissible as a basis for measuring the constitutionality of returns on residential rental property.

5. For purposes of determining a just and reasonable return on the value of residential rental property under a rent control ordinance or regulation, the value of the property should be interpreted as the fair market value of such property, as defined by Section 1263.320 of the Code of Civil Procedure; and as determined upon the basis of relevant evidence thereof as set forth in Division 7, Chapter 1, Article 2 of the California Evidence Code. Since data for rental properties in relevant markets is readily available, historic cash investment is not a permissible factor upon which an expert may reasonably rely in forming an opinion as to the value of residential rental property; nor may sales of the subject property be taken into account, unless such a sale occurred within reasonable time before or after the date of value.

6. The effect of the Rent Control Amendment itself and the Rent Control Board's interpretation and application thereof may not be considered in determining the value of the controlled rental property.

7. In each instance in the Rent Control Amendment in which the phrase "return on investment" is used, said phrase shall be interpreted to mean "return on the value of the property" in order to give a constitutionally valid construction to the language of the Amendment.

8. The reduction in rent to those levels in effect one year before enactment of the Rent Control Amendment (*i.e.*, April 10, 1978) when the market was assumed to be in equilibrium is constitutionally permissible, provided adjustments are made to allow for the effects of inflation to April 10, 1979. The portion of Section 1804(b) providing the roll back of rents to April 10, 1978 is, therefore, not unconstitutional on its face.

9. The presumption that April 10, 1978 rents assured owners a just and reasonable return as defined by Regulation 4040 and applied by the Board prior to its adoption of Regulations 4100, *et seq.*, violates Sections 1, 7 and 19 of Article 1 and Section 7 of Article 11 of the California Constitution, as well as the Fifth and Fourteenth Amendments of the United States Constitution.

10. The net rental income realized by landlords on April 10, 1978, did not provide them with a just and reasonable return on the value of their property if anticipated appreciation be excluded.

11. That portion of the next to last sentence of Section 1805(e) reading "the speculative nature of the investment, whether or not the property was acquired or is held as a long-term or short-term investment . . ." is unconstitutional in that it violates the equal protection clause of the Fourteenth Amendment, making arbitrary distinctions with no rational basis among owners of similar properties, on the basis of such subjective criteria as individual motives and length of ownership and denies a significant number of owners their right to a just and reasonable return on their property in violation of Sections 1, 7 and 19 of Article 1 and Section 7 of Article 11 of the California Constitution, as well as the Fifth and Fourteenth Amendments of the United States Constitution.

12. Sections 1805(f) and (g) are unconstitutional in that they:

(a) deny owners their constitutional right to a just and reasonable return on their property;

(b) make arbitrary distinctions with no rational basis among owners of equal properties on the basis of the purchase dates, financing terms, original purchase price, and other subjective factors; and

(c) appropriate past return in the form of appreciation on the arbitrary, subjective, and

individual bases identified in the foregoing subparagraph.

Said sections violate Sections 1, 7 and 19 of Article 1 and Section 7 of Article 11 of the California Constitution, as well as the Fifth and Fourteenth Amendments of the United States Constitution.

13. Regulation 4040 is unconstitutional on its face and as applied. The provisions thereof are so intertwined that those portions which may be constitutional cannot be severed.

14. Section 1812 of the Rent Control Amendment is a valid severability clause and those portions of the Amendment herein determined to be unconstitutional may be severed from the remainder.

15. Section 1803(n) of the Santa Monica City Charter and Chapter 11 of the Santa Monica Rent Control Board's Regulations (commencing with Section 11000), pertaining to registration fees, are not in violation of Article XIIIA of the California Constitution.

16. For the Rent Control Board to require appropriate tax return information in connection with petitions for rent increase is not violative law.

17. Assuming that landlords may in good faith demolish their units at any time and realize the value of the land, Plaintiffs have failed to meet their burden of proof that Regulations 4100-4111 (the "4100 Regulations") of the Rent Control Board are unconstitutional on their face.

18. No determination is made considering whether the Rent Control Board has or will handle individual rent petitions under the 4100 Regulations in a constitutional manner or has or will reach a constitutional decision on any individual petition. The constitutionality of any particular decision on an individual petition depends upon whether the return allowed to the landlord provides the landlords, in that particular case, with a fair return on the value of his or her property.

19. The 4100 Regulations of the Rent Control Board are not ultra vives.

20. Section 1803(t) is facially unconstitutional, since to obtain a Category I removal permit an owner must meet four separate conditions, whereas satisfaction of the fourth condition alone (*i.e.*, inability to make a fair return) is sufficient to constitutionally require authorization to withdraw from the regulated residential rental market.

21. The portions of Section 1803(t) that may be constitutional are not severable from the remainder of Section 1803(t).

22. Section 1803(t) is severable from the remainder of the Rent Control Amendment as a whole.

23. Section 1803(t), Ordinance 1255 of the City of Santa Monica and Regulations 5012 through 5016, inclusive, enacted September 3, 1983 by the Santa Monica Rent Control Board (hereinafter the "Removal Regulations") are invalid in that they are in conflict with the California statewide policies set forth in Chapter 1207 of the California Statutes, 1979.

24. The Removal Regulations are invalid and unconstitutional on their face in that they deny landlords procedural due process.

25. Section 1803(t) of the Rent Control Ordinance, Ordinance 1255 and the Removal Regulations are, in combination with the 4100 Regulations, unconstitutional in that the combined effect of the 4100 Regulations with any one of Section 1803(t), Ordinance 1255 or the Removal Regulations will deny a substantial number of efficient landlords a just and reasonable return on their properties.

26. A permanent injunction, should issue prohibiting, restraining, and enjoining the Santa Monica Rent Control Board and the City of Santa Monica, their agents and employees, notwithstanding any other provision of law, from regulating or prohibiting, directly or indirectly, demolitions of residential rental housing except as follows:

a. Such regulations may be enacted as are reasonable and necessary to ensure that the physical demolition of the property will not be hazardous to the public health and safety;

b. Regulations may be enacted delaying the effective date of the demolition permit to provide the tenants of the affected unit time to find alternate housing. Such regulation shall not serve, assuming timely compliance by the landlord of the notice requirements of State law, to extend any tenant's obligation to quit the premises beyond 120 days from the date of the filing of the application for the demolition permit;

c. A regulation may be enacted providing that, if within 45 days of the filing of an application for a demolition permit the City makes a good faith finding based upon clear and convincing evidentiary testimony that economic considerations are not a substantial factor in the owner's intentions in filing an application for a demolition permit, the City may then, and only then, reject such application; and

d. This injunction may be reconsidered upon the request of the defendants in the event that Defendant Rent Control Board adopts new regulations for determining general and individual rent adjustments.

e. This injuction shall not go into effect and its enforcement is stayed for a period of sixty (60) days from the date of this judgment as set forth below.

27. The Court retains jurisdiction to consider and rule on Plaintiffs' request for attorneys' fees.

28. Plaintiffs shall recover their costs herein in the sum of $_____ from the Rent Control Board and the City of Santa Monica. The City of Santa Monica and the Santa

Monica Rent Control Board shall recover costs therein of $_____ from plaintiffs.

DATED: July 14, 1983.

Richard A Lavine

RICHARD A. LAVINE
Judge of the Superior Court

RENT CONTROL CHARTER AMENDMENT

ARTICLE XVIII. RENT CONTROL

Section 1800. Statement of Purpose. A growing shortage of housing units resulting in a low vacancy rate and rapidly rising rents exploiting this shortage constitute a serious housing problem affecting the lives of a substantial portion of those Santa Monica residents who reside in residential housing. In addition, speculation in the purchase and sale of existing residential housing units results in further rent increases. These conditions endanger the public health and welfare of Santa Monica tenants, especially the poor, minorities, students, young families, and senior citizens. The purpose of this Article, therefore, is to alleviate the hardship caused by this serious housing shortage by establishing a Rent Control Board empowered to regulate rentals in the City of Santa Monica so that rents will not be increased unreasonably and so that landlords will receive no more than a fair return on their investment.

In order to accomplish this purpose, this Article provides for an elected rent control board to ensure that rents are at a fair level by requiring landlords to justify any rents in excess of the rents in effect one year prior to the adoption of this Article. Tenants may seek rent reductions from the rent in effect one year prior to the adoption of this Article by establishing that those rents are excessive. In addition to giving tenants an opportunity to contest any rent increase, this Article attempts to provide reasonable protection to tenants by controlling removal of controlled rental units from the housing market and by requiring just cause for any eviction from a controlled rental unit.

Section 1801. Definitions. The following words or phrases as used in this Article shall have the following meanings:

(a) BOARD: The term "Board" refers to the elected rent control board established by this Article.

(b) COMMISSIONERS: The members of the Board and Interim Board are denominated Commissioners.

(c) CONTROLLED RENTAL UNITS: All residential rental units in the City of Santa Monica, including mobile homes and mobile home spaces and trailers and trailer spaces, except:

(1) Rental units in hotels, motels, inns, tourist homes and rooming and boarding houses which are rented primarily to transient guests for a period of less than fourteen (14) days.

(2) Rental units in any hospital, convent, monastery, extended medical care facility, asylum, non-profit home for the aged, or dormitory owned and operated by an institution of higher education.

(3) Rental units which a government unit, agency or authority owns, operates, manages or in which governmentally-subsidized tenants reside only if applicable Federal or State law or administrative regulation specifically exempt such units from municipal rent control.

(4) Rental units in owner occupied dwellings with no more than three (3) units.

(5) Rental units and dwellings constructed after the adoption of this Article; this exemption does not apply to units created as a result of conversion as opposed to new construction.

(d) HOUSING SERVICE: Housing services include but are not limited to repairs, maintenance, painting, providing light, hot and cold water, elevator service, window shades and screens, storage, kitchen, bath and laundry facilities and privileges, janitor services, refuse removal, furnishings, telephone, parking and any other benefit, privilege or facility connected with the use or occupancy of any rental unit. Services to a rental unit shall include a proportionate part of services provided to common facilities of the building in which the rental unit is contained.

(e) LANDLORD: An owner, lessor, sublessor or any other person entitled to receive rent for the use and occupancy of any rental unit, or an agent, representative or successor of any of the foregoing.

(f) RENT: All periodic payments and all nonmonetary consideration including but not limited to, the fair market value of goods or services rendered to or for the benefit of the landlord under an agreement concerning the use or occupancy of a rental unit and premises, including all payment and consideration demanded or paid for parking, pets, furniture, subletting and security deposits for damages and cleaning.

(g) RENTAL HOUSING AGREEMENT: An agreement, oral, written or implied, between a landlord and tenant for use or occupancy of a rental unit and for housing services.

(h) RENTAL UNITS: Any building, structure, or part thereof, or land appurtenant thereto, or any other rental property rented or offered for rent for living or dwelling house units, and other real properties used for living or dwelling purposes, together

with all housing services connected with use or occupancy of such property such as common areas and recreational facilities held out for use by the tenant.

(i) TENANT: A tenant, subtenant, lessee, sublessee or any other person entitled under the terms of a rental housing agreement to the use or occupancy of any rental unit.

(j) RECOGNIZED TENANT ORGANIZATION: Any group of tenants, residing in controlled rental units in the same building or in different buildings operated by the same management company, agent or landlord, who requests to be so designated.

(k) RENT CEILING: Rent ceiling refers to the limit on the maximum allowable rent which a landlord may charge on any controlled rental unit.

(l) BASE RENT CEILING: The maximum allowable rent established in Section 1804(b).

Section 1802. Interim Rent Control Board:

No later than thirty (30) days after the adoption of this Article, the City Council of the City of Santa Monica shall appoint a five-member Interim Rent Control Board. No person shall be appointed to the Interim Rent Control Board unless he or she is a duly qualified elector of the City of Santa Monica. The Interim Board shall exercise the following powers and duties until the Permanent Board is elected in accordance with the provisions of Section 1803(d) and assumes office;

(1) Require registration of all controlled rental units under Section 1803(q).

(2) Seek criminal penalties under Section 1810.

(3) Seek injunctive relief under Section 1811.

Section 1803. Permanent Rent Control Board:

(a) COMPOSITION: There shall be in the City of Santa Monica a Rent Control Board. The Board shall consist of five elected Commissioners. The Board shall elect annually as chairperson one of its members to serve in that capacity.

(b) ELIGIBILITY: Duly qualified electors of the City of Santa Monica are eligible to serve as Commissioners of the Board.

(c) FULL DISCLOSURE OF HOLDINGS: Candidates for the position of Commissioner shall submit a verified statement listing all of their interests and dealings in real property, including but not limited to its ownership, sale or management, during the previous three (3) years.

(d) ELECTION OF COMMISSIONERS: Commissioners shall be elected at general municipal elections in the same manner as set forth in Article XIV of the Santa Monica City Charter, except that the first Commissioners shall be elected at a special municipal election held within ninety (90) days of the adoption of this Article. The elected Commissioners shall take office on the first Tuesday following their election.

(e) TERM OF OFFICE: Commissioners shall be elected to serve terms of four years, beginning on the first Tuesday following their election, except that of the first five Commissioners elected in accordance with Section 1803(d), the two Commissioners receiving the most votes shall serve until April 15, 1985 and the remaining three Commissioners shall serve until April 18, 1983. Commissioners shall serve a maximum of two full terms.

(f) POWERS AND DUTIES: The Board shall have the following powers and duties:

(1) Set the rent ceilings for all controlled rental units.

(2) Require registration of all controlled rental units under Section 1803(q).

(3) Establish a base ceiling on rents under Section 1804(b).

(4) To make adjustments in the rent ceiling in accordance with Section 1805.

(5) Set rents at fair and equitable levels in order to achieve the intent of this Article.

(6) Hire and pay necessary staff, including hearing examiners and personnel to issue orders, rules and regulations, conduct hearings and charge fees as set forth below.

(7) Make such studies, surveys and investigations, conduct such hearings, and obtain such information as is necessary to carry out its powers and duties.

(8) Report annually to the City Council of the City of Santa Monica on the status of controlled rental housing.

(9) Remove rent controls under Section 1803(r).

(10) Issue permits for removal of controlled rental units from rental housing market under Section 1803(t).

(11) Administer oaths and affirmations and subpoena witnesses.

(12) Establish rules and regulations for deducting penalties and settling civil claims under Section 1809.

(13) Seek criminal penalties under Section 1810.

(14) Seek injunctive relief under Section 1811.

(g) RULES AND REGULATIONS: The Board shall issue and follow such rules and regulations, including those which are contained in this Article, as will further the purposes of the Article. The Board shall publicize its rules and regulations prior to promulgation in at least one newspaper of general circulation in the City of Santa Monica. The Board shall hold at least one (1) public hearing to consider the views of interested parties prior to the adoption of general adjustments of the ceilings for maximum allowable rents under Section 1805 and any decision to decontrol or re-impose control for any class of rental units under Section 1803(r). All rules and regulations, internal staff memoranda, and written correspondence explaining the decisions, orders, and policies of the Board shall be kept in the Board's office and shall be available to the public for inspection and copying. The Board shall publicize this Article so that all residents of Santa Monica will have the opportunity to become informed about their legal rights and duties under rent control in Santa Monica. The Board shall prepare a brochure which fully describes the legal rights and duties of landlords and tenants under rent control in Santa Monica. The brochure will be available to the public, and each tenant of a controlled rental unit shall receive a copy of the brochure from his or her landlord.

(h) MEETINGS: The Board shall hold at least forty-eight (48) regularly scheduled meetings per year. Special meetings shall be called at the request of at least three Commissioners of the Board. The Board shall hold its initial meeting no later than 15 days after taking office.

(i) QUORUM: Three Commissioners shall constitute a quorum for the Board.

(j) VOTING: The affirmative vote of three Commissioners of the Board is required for a decision, including all motions, regulations, and orders of the Board.

(k) COMPENSATION: Each Commissioner shall receive for every meeting attended seventy-five dollars ($75.00), but in no event shall any Commissioner receive in any twelve month period more than forty-seven hundred and fifty dollars ($4,750) for services rendered.

(l) DOCKETS: The Board shall maintain and keep in its office all hearing dockets.

(m) VACANCIES: If a vacancy shall occur on the Board, the Board shall within thirty (30) days appoint a qualified person to fill such a vacancy until the following municipal election when a qualified person shall be elected to serve for the remainder of the term.

(n) FINANCING: The Board shall finance its reasonable and necessary expenses by charging landlords annual registration fees in amounts deemed reasonable by the Board. The first annual registration fee shall be set by the Board within thirty days after assuming office. The Board is also empowered to request and receive funding when and if necessary, from any available source for its reasonable and necessary expenses. Notwithstanding the preceding provisions of this paragraph, the City Council of the City of Santa Monica shall appropriate sufficient funds for the reasonable and necessary expenses of the Interim Board and Board during the six month period following adoption of this Article.

(o) RECALL: Commissioners may be recalled in accordance with the provisions of Article XIV of the Santa Monica City Charter.

(p) STAFF: The Board shall employ and pay such staff, including hearing examiners and inspectors, as may

be necessary to perform its functions efficiently in order to fulfill the purposes of this Article.

(q) REGISTRATION: Within sixty (60) days after the adoption of the Article, the Board shall require the registration of all controlled rental units, which shall be re-registered at times deemed appropriate by the Board. The initial registration shall include the rent in effect at the time on the date of the adoption of this Article, base rent ceiling, the address of the rental unit, the name and address of the landlord, the housing services provided to the unit, a statement indicating all operating cost increases since the base rent ceiling date, and any other information deemed relevant by the Board. The Board shall require the landlord to report vacancies in the controlled rental units and shall make a list of vacant controlled rental units available to the public. If the Board, after the landlord has proper notice and after a hearing, determines that a landlord has wilfully and knowingly failed to register a controlled rental unit, the Board may authorize the tenant of such a nonregistered controlled rental unit to withhold all or a portion of the rent for the unit until such time as the rental unit is properly registered. After a rental unit is properly registered, the Board shall determine what portion, if any, of the withheld rent is owed to the landlord for the period in which the rental unit was not properly registered. Whether or not the Board allows such withholding, no landlord who has failed to register properly shall at any time increase rents for a controlled rental unit until such units are properly registered.

(r) DECONTROL: If the average annual vacancy rate in any category, classification, or area of controlled rental units exceeds five (5) percent, the Board is empowered, at its discretion and in order to achieve the objectives of this Article, to remove rent controls from such category,

classification or area. The Board may determine such categories, classifications, or areas for purposes of decontrol consistent with the objectives of this Article. In determining the vacancy rate for any category, classification or area of controlled rental units, the Board shall consider all available data and shall conduct its own survey. If units are decontrolled pursuant to this subsection, controls shall be reimposed if the Board finds that the average annual vacancy rate has thereafter fallen below five (5) percent for such category, classification or area.

(s) SECURITY DEPOSITS: Any payment or deposit of money the primary function of which is to secure the performance of a rental agreement or any part of such agreement, including an advance payment of rent, shall be placed in an interest bearing account at an institution whose accounts are insured by the Federal Savings and Loan Insurance Corporation until such time as it is returned to the tenant or entitled to be used by the landlord. The interest on said account shall be used by the landlord to offset operating expenses and shall be a factor in making individual rent adjustments under Section 1805. In lieu of complying with this requirement, the landlord may pay interest directly to the tenant in accordance with the requirements of any state law.

(t) REMOVAL OF CONTROLLED RENTAL UNIT FROM RENTAL HOUSING MARKET: Any landlord who desires to remove a controlled rental unit from the rental housing market by demolition, conversion or other means is required to obtain a permit from the Board prior to such removal from the rental housing market in accordance with rules and regulations promulgated by the Board. In order to approve such a permit, the Board is required to make each of the following findings;

(1) That the controlled rental unit is not occupied by a person or family of very low income, low income or moderate income.

(2) That the rent of the controlled rental unit is not at a level affordable by a person or family of very low income, low income, or moderate income.

(3) That the removal of the controlled rental unit will not adversely affect the supply of housing in the City of Santa Monica.

(4) That the landlord cannot make a fair return on investment by retaining the controlled rental unit.

Notwithstanding the foregoing provisions of this subsection, the Board may approve such a permit:

(1) If the Board finds that the controlled rental unit is uninhabitable and is incapable of being made habitable in an economically feasible manner, or

(2) If the permit is being sought so that the property may be developed with multifamily dwelling units and the permit applicant agrees as a condition of approval that the units will not be exempt from the provisions of this Article pursuant to Section 1801(c) and that at least fifteen (15) percent of the controlled rental units to be built on the site will be at rents affordable by persons of low income.

Section 1804. Maximum Allowable Rents.

(a) TEMPORARY FREEZE: Rents shall not be increased during the one hundred-twenty (120) day period following the date of adoption of this Article.

(b) ESTABLISHMENT OF BASE RENT CEILING: Beginning one-hundred-twenty (120) days after the adoption of this Article, no landlord shall charge rent for any controlled rental units in an amount greater than

the rent in effect on the date one year prior to the adoption of this Article. The rent in effect on that date is the base rent ceiling and is a reference point from which fair rents shall be adjusted upward or downward in accordance with Section 1805. If there was no rent in effect on the date one year prior to the adoption of this Article, the base rent ceiling shall be the rent that was charged on the first date that rent was charged following the date one year prior to the adoption of this Article.

(c) POSTING: As soon as the landlord is aware of the maximum allowable rent, the landlord shall post it for each unit in a prominent place in or about the affected controlled rent units. The Board may require that other information it deems relevant also be posted.

Section 1805. Individual and General Adjustment of Ceilings on Allowable Rents.

(a) The Board may, after holding those public hearings prescribed by Section 1803(g), set and adjust upward or downward the rent ceiling for all controlled rental units in general and/or for particular categories of controlled rental units deemed appropriate by the Board. Such an adjustment, however, need not take effect immediately, and the Board may decide that new rent ceilings shall not take effect until some reasonable date after the above-stated time periods.

(b) Each year the Board shall generally adjust rents as follows:

(1) Adjust rents upward by granting landlords a utility and tax increase adjustment for actual increases in the City of Santa Monica for taxes and utilities.

(2) Adjust rents upward by granting landlords a maintenance increase adjustment for actual increases in the City of Santa Monica for maintenance expenses.

(3) Adjust rents downward by requiring landlords to decrease rents for any actual decreases in the City of Santa Monica for taxes.

In adjusting rents under this subsection, the Board shall adopt a formula of general application. This formula will be based upon a survey of landlords of the increases or decreases in the expenses set forth in this subsection.

(c) PETITIONS: Upon receipt of a petition by a landlord and/or a tenant, the maximum rent of individual controlled rental units may be adjusted upward or downward in accordance with the procedures set forth elsewhere in this Section. The petition shall be on the form provided by the Board. Notwithstanding any other provision of this Section, the Board or hearing examiner may refuse to hold a hearing and/or grant a rent adjustment if an individual hearing has been held and decision made with regard to maximum rent within the previous six months.

(d) HEARING PROCEDURE: The Board shall enact rules and regulations governing hearings and appeals of individual adjustment of ceilings on allowable rents which shall include the following:

(1) Hearing Examiner: A hearing examiner appointed by the Board shall conduct a hearing to act upon the petition for individual adjustment of ceilings on allowable rents and shall have the power to administer oaths and affirmations.

(2) Notice: The Board shall notify the landlord if the petition was filed by the tenant, or the tenant, if

the petition was filed by the landlord, of the receipt of such a petition and a copy thereof.

(3) Time of Hearing: The hearing officer shall notify all parties as to the time, date and place of the hearing.

(4) Records: The hearing examiner may require either party to a rent adjustment hearing to provide it with any books, records and papers deemed pertinent in addition to that information contained in registration statements. The hearing examiner shall conduct a current building inspection and/or request the City to conduct a current building inspection if the hearing examiner finds good cause to believe the Board's current information does not reflect the current condition of the controlled rental unit. The tenant may request the hearing examiner to order such an inspection prior to the date of the hearing. All documents required under this Section shall be made available to the parties involved prior to the hearing at the office of the Board. In cases where information filed in a petition for rent ceiling adjustment or in additional submissions filed at the request of the hearing examiner is inadequate or false, no action shall be taken on said petition until the deficiency is remedied.

(5) OPEN HEARINGS: All rent ceiling adjustment hearings shall be open to the public.

(6) RIGHT OF ASSISTANCE: All parties to a hearing may have assistance in presenting evidence and developing their position from attorneys, legal workers, recognized tenant organization representatives or any other persons designated by said parties.

(7) HEARING RECORD: The Board shall make available for inspection and copying by any person an

official record which shall constitute the exclusive record for decision of the issues at the hearing. The record of the hearing, or any part of one, shall be obtainable for the cost of copying. The record of the hearing shall include: all exhibits, papers and documents required to be filed or accepted into evidence during the proceedings; a list of participants present; a summary of all testimony accepted in the proceedings; a statement of all materials officially noticed; all recommended decisions; orders and/or rulings; all final decisions, orders and/or rulings, and the reasons for each final decision, order and/or ruling. Any party may have the proceeding tape recorded or otherwise transcribed at his or her own expense.

(8) QUANTUM OF PROOF AND NOTICE OF DECISION: No individual adjustment shall be granted unless supported by the preponderance of the evidence submitted at the hearing. All parties to a hearing shall be sent a notice of the decision and a copy of the findings of fact and law upon which said decision is based. At the same time, parties to the proceeding shall also be notified of their right to any appeal allowed by the Board and/or to judicial review of the decision pursuant to this Section and Section 1808 of this Article.

(9) CONSOLIDATION: All landlord petitions pertaining to tenants in the same building will be consolidated for hearing, and all petitions filed by tenants occupying the same building shall be consolidated for hearing unless there is a showing of good cause not to consolidate such petitions.

(10) APPEAL: Any person aggrieved by the decision of the hearing examiner may appeal to the Board. On appeal, the board shall affirm, reverse or modify the decision of the hearing examiner. The

Board may conduct a de novo hearing or may act on the basis of the record before the hearing examiner without holding a hearing.

(11) FINALITY OF DECISION: The decision of the hearing examiner shall be the final decision of the Board in the event of no appeal to the Board. The decision of the hearing examiner shall not be stayed pending appeal; however, in the event that the Board on appeal reverses or modifies the decision of the hearing examiner, the landlord, in the case of a upward adjustment in rent, or the tenant, in the case of a downward adjustment of rent, shall be ordered to make retroactive payments to restore the parties to the position they would have occupied had the hearing examiner's decision been the same as that of the Board's.

(12) TIME FOR DECISION: The rules and regulations adopted by the Board shall provide for final board action on any individual rent adjustment petition within one-hundred and twenty (120) days following the date of filing of the individual rent adjustment petition.

(13) BOARD ACTION IN LIEU OF REFERENCE TO HEARING EXAMINER: The Board, on its own motion or on the request of any landlord or tenant, may hold a hearing on an individual petition for rent adjustment without the petition first being heard by a hearing examiner.

(e) In making individual and general adjustments of the rent ceiling, the Board shall consider the purposes of this Article and shall specifically consider all relevant factors including but not limited to increases or decreases in property taxes, unavoidable increases or decreases in

operating and maintenance expenses, capital improvement of the controlled rental unit as distinguished from normal repair, replacement and maintenance, increases or decreases in living space, furniture, furnishings or equipment, substantial deterioration of the controlled rental unit other than as a result of ordinary wear and tear, failure on the part of the landlord to provide adequate housing services or to comply substantially with applicable housing, health and safety codes, federal and state income tax benefits, the speculative nature of the investment, whether or not the property was acquired or is held as a long term or short term investment, and the landlords rate of return on investment. It is the intent of this Article that upward adjustments in rent be made only when demonstrated necessary to the landlord making a fair return on investment.

(f) No rent increase shall be authorized by this Article because a landlord has a negative cash flow as the result of refinancing the controlled rental unit if at the time the landlord refinanced the landlord could reasonably have foreseen a negative cash flow based on the rent schedule then in existence within the one year period following refinancing. This paragraph shall only apply to that portion to the negative cash flow reasonably foreseeable within the one year period following refinancing of the controlled rental unit and shall only apply to controlled rental units refinanced after the date of adoption of this Article.

(g) No rent increase shall be authorized by this Article because a landlord has a negative cash flow if at the time the landlord acquired the controlled rental unit, the landlord could reasonably have foreseen a negative cash flow based on the rent schedule then in existence within the one year period following acquisition. This paragraph shall only apply to that portion of the negative cash flow

reasonably foreseeable within the one year period following acquisition of a controlled rental unit and shall only apply to controlled rental units acquired after the date of adoption of this Article.

(h) No landlord shall increase rent under this Section if the landlord:

(1) Has failed to comply with any provision of this Article and/or regulations issued thereunder by the Board, or

(2) Has failed to comply substantially with any applicable state or local housing, health or safety law.

Section 1806. Eviction:

No landlord shall bring any action to recover possession or be granted recovery of possession of a controlled rental unit unless:

(a) The tenant has failed to pay the rent to which the landlord in entitled under the rental housing agreement and this Article.

(b) The tenant has violated an obligation or covenant of his or her tenancy other than the obligation to surrender possession upon proper notice and has failed to cure such violation after having received written notice thereof from the landlord in the manner required by law.

(c) The tenant is committing or expressly permitting a nuisance in, or is causing substantial damage to, the controlled rental unit, or is creating a substantial interference with the comfort, safety, or enjoyment of the landlord or other occupants or neighbors of the same.

(d) The tenant is convicted of using or expressly permitting a controlled rental unit to be used for any illegal purpose.

(e) The tenant, who had a rental housing agreement which has terminated, has refused, after written request or demand by the landlord, to execute a written extension or renewal thereof for a further term of like duration and in such terms as are not inconsistent with or violative of any provisions of this Article and are materially the same as in the previous agreement.

(f) The tenant has refused the landlord reasonable access to the controlled rental unit for the purpose of making necessary repairs or improvements required by the laws of the United States, the State of California or any subdivision thereof, or for the purpose of showing the rental housing unit to any prospective purchaser or mortgagee.

(g) The tenant holding at the end of the term of the rental housing agreement is a sub-tenant not approved by the landlord.

(h) The landlord seeks to recover possession in good faith for use and occupancy of herself or himself, or her or his children, parents, brother, sister, father-in-law, mother-in-law, son-in-law, or daughter-in-law.

(i) The landlord seeks to recover possession to demolish or otherwise remove the controlled rental unit from rental residential housing use after having obtained all proper permits from the City of Santa Monica.

Notwithstanding the above provisions, possession shall not be granted if it is determined that the eviction is in retaliation for the tenant reporting violations of this

Article, for exercising rights granted under this Article, including the right to withhold rent upon authorization of the Board under Section 1803(q) or Section 1809 or for organizing other tenants. In any action brought to recover possession of a controlled rental unit, the landlord shall allege and prove compliance with this Section.

Section 1807. Non-waiverability: Any provision, whether oral or written in or pertaining to a rental housing agreement whereby any provision of this Article for the benefit of the tenant is waived, shall be deemed to be against public policy and shall be void.

Section 1808. Judicial Review: A landlord or tenant aggrieved by any action or decision of the Board may seek judicial review by appealing to the appropriate court within the jurisdiction.

Section 1809. Civil Remedies:

(a) Any landlord who demands, accepts, receives, or retains any payment of rent in excess of the maximum lawful rent, in violation of the provisions of this Article or any rule, regulation or order hereunder promulgated, shall be liable as hereinafter provided to the tenant from whom such payments are demanded, accepted, received or retained, for reasonable attorney's fees and costs as determined by the court, plus damages in an amount of five hundred dollars ($500) or three (3) times the amount by which the payment or payments demanded, accepted, received or retained exceeds the maximum lawful rent, whichever is the greater.

(b) In lieu of filing a civil action as provided for in Section 1809(a), the Board shall establish by rule and regulation a hearing procedure similar to that set forth in Section 1805(d) for determination of the amount of the penalty the tenant is entitled to pursuant to Section

1809(a). After said determination, the tenant may deduct the penalty from future rent payments in the manner provided by the Board.

(c) If the tenant from whom such excessive payment is demanded, accepted, received or retained in violation of the foregoing provisions of this Article or any rule or regulation or order hereunder promulgated fails to bring a civil or administrative action as provided for in Section 1809(a) and 1809(b) within one-hundred and twenty (120) days from the date of occurrence of the violation, the Board may settle the claim arising out of the violation or bring such action. Thereafter, the tenant on whose behalf the Board acted is barred from also bringing an action against the landlord in regard to the same violation for which the Board has made a settlement or brought an action. In the event the Board settles said claim, it shall be entitled to retain the costs it incurred in settlement thereof, and the tenant against whom the violation has been committed shall be entitled to the remainder.

(d) The appropriate court in the jurisdiction in which the controlled rental unit affected is located shall have jurisdiction over all actions brought under this Section.

Section 1810. Criminal Remedies. Any landlord violating this Article shall be guilty of a misdemeanor. Any landlord convicted of a misdemeanor under the provisions of this Article shall be punished by a fine of not more than five hundred dollars ($500) or by imprisonment in the county jail for a period not exceeding six months, or by both such fine and imprisonment.

Section 1811. Injunctive Relief. The Board, and tenants and landlords of controlled units, may seek relief from the appropriate court within the jurisdiction within which the affected controlled rental unit is located to

restrain or enjoin any violation of this Article and of the rules, regulations, orders and decisions of the Board.

Section 1812. Partial Invalidity. If any provision of this Article or application thereof to any person or circumstances is held invalid, this invalidity shall not affect other provisions or applications of this Article which can be given effect without the invalid provision or application, and to this end the provisions of this Article are declared to be severable. This Article shall be liberally construed to achieve the purposes of this Article and to preserve its validity.

ARTICLE XVIII. RENT CONTROL

Section 1800. *Statement of Purpose.* A growing shortage of housing units resulting in a low vacancy rate and rapidly rising rents exploiting this shortage constitute a serious housing problem affecting the lives of a substantial portion of those Santa Monica residents who reside in residential housing. In addition, speculation in the purchase and sale of existing residential housing units results in further rent increases. These conditions endanger the public health and welfare of Santa Monica tenants, especially the poor, minorities, students, young families, and senior citizens. The purpose of this Article, therefore, is to alleviate the hardship caused by this serious housing shortage by establishing a Rent Control Board empowered to regulate rentals in the City of Santa Monica so that rents will not be increased unreasonably and so that landlords will receive no more than a fair return.

In order to accomplish this purpose, this Article provides for an elected Rent Control Board to ensure that rents are at a fair level by requiring landlords to justify any rents in excess of the rents in effect one year prior to the adoption of this Article. Tenants may seek rent reductions from the rent in effect one year prior to the adoption of this Article by establishing that those rents are excessive. In addition to giving tenants an opportunity to contest any rent increase, this Article attempts to provide reasonable protection to tenants by controlling removal of controlled rental units from the housing market and by requiring just cause for any eviction from a controlled rental unit.

Through this Article, the City exercises its police power in order to address the serious housing problem recognized in the original enactment of this Rent Control Law in 1979 and still existing in 1984. The 1984 Amendment to the Rent Control Law is intended to clarify the law and ensure that the Rent Control Board possesses adequate and independent authority to carry out its duties. It is intended to ensure due process of law for landlords and tenants, effective remedies for violation of the law, and consistency with constitutional requirements. It is also intended to enable the Board to provide relief to persons facing particular hardship and to protect and increase the supply of affordable housing in the City. Termination or erosion of the protections of this Article would have serious disruptive consequences for persons in need of protection and the supply of affordable housing in the City.

Section 1801. *Definitions.* The following words or phrases as used in this Article shall have the following meanings:

(a) *Board:* The term "Board" refers to the elected Rent Control Board established by this Article.

(b) *Commissioners:* The members of the Board and Interim Board are denominated Commissioners.

(c) *Controlled Rental Units:* All residential rental units in the City of Santa Monica, including mobile homes, and mobile home spaces, and trailers and trailer spaces, except single family homes to the extent provided for in section 1815 and those units found by the Board to be exempt under one or more of the following provisions:

(1) Rental units in hotels, motels, inns, tourist homes and rooming and boarding houses which are rented primarily to transient guests for a period of less than fourteen (14) days.

(2) Rental units in any hospital, convent, monastery, extended medical care facility, asylum, nonprofit home for the aged, or dormitory owned and operated by an institution of higher education.

(3) Rental units which a government unit, agency or authority owns, operates, manages, or in which governmentally subsidized tenants reside only if applicable Federal or State law or administrative regulation specially exempt such units from municipal rent control.

(4) Rental units in owner-occupied dwellings with no more than three (3) units. For purposes of this section:

(i) The term "owner" means a natural person who owns a fifty (50) percent ownership interest in the building and resides on the property as his or her principal place of residence.

(ii) An exemption under this section shall expire by operation of law when the owner ceases to reside on the property as his or her principal place of residence; thereafter, all units on the property shall be subject to all provisions of this Article.

(5) Rental units and dwellings constructed after the adoption of this Article; this exemption does not apply to units created as a result of conversion as opposed to new construction.

(6) Where a unit is actually used for purposes of providing, on a non-profit basis, child care or other residential social services in accordance with applicable laws. This exemption shall expire when the use upon which exemption is based ceases. This exemption shall only apply to units as they become vacant and shall only operate to allow the specified use without the necessity of obtaining a removal permit

under this Article. This exemption shall not be construed to authorize the eviction of any tenant nor to authorize the charging of rent in excess of that permitted under this Article. The Board may adopt regulations to determine whether a unit qualifies for an exemption under this section.

(7) Exemptions are not automatic but shall be granted by the Board upon application by the owner pursuant to Board rules, provided that if the Board does not act upon a completed application for exemption within ninety (90) days of its filing it shall be deemed approved.

(d) *Housing Service:* Housing services include, but are not limited to repairs, maintenance, painting, providing light, hot and cold water, elevator service, window shades and screens, storage, kitchen, bath and laundry facilities and privileges, janitor services, refuse removal, furnishings, telephone, parking, and any other benefit, privilege or facility connected with the use or occupancy of any rental unit. Services to a rental unit shall include a proportionate part of services provided to common facilities of the building in which the rental unit is contained.

(e) *Landlord*: An owner, lessor, sublessor or any other person entitled to receive rent for the use and occupancy of any rental unit, or an agent, representative or successor of any of the foregoing.

(f) *Rent:* All periodic payments and all nonmonetary consideration including but not limited to, the fair market value of goods or services rendered to or for the benefit of the landlord under an agreement concerning the use or occupancy of a rental unit and premises including all payment and consideration demanded or paid for parking, pets, furniture, subletting and security deposits for damages and cleaning.

(g) *Rental Housing Agreement:* An agreement, oral, written or implied, between a landlord and tenant for use or occupancy of a rental unit and for housing services.

(h) *Rental Units:* Any building, structure, or part thereof, or land appurtenant thereto, or any other rental property rented or offered for rent for living or dwelling house units, together with all housing services connected with use or occupancy of such property such as common areas and recreational facilities held out for use by the tenant.

(i) *Tenant:* A tenant, subtenant, lessee, sublessee or any other person entitled under the terms of a rental housing agreement to the use or occupancy of any rental unit.

(j) *Recognized Tenant Organization:* Any group of tenants residing in controlled rental units in the same building or in different buildings operated by the same management company, agent or landlord, who requests to be so designated.

(k) *Rent Ceiling:* Rent ceiling refers to the limit on the maximum allowable rent which a landlord may charge on any controlled rental unit.

(l) *Base Rent Ceiling:* The maximum allowable rent established in Section 1804(b).

(m) *Property:* All rental units on a parcel or lot or contiguous parcels or contiguous lots under common ownership.

(n) *Single Family Home:* A property that has been developed with only one one-family dwelling and any lawful accessory structures, or a lawfully created condominium, stock cooperative or similar unit that is part of a larger residential structure or complex, excepting those

condominiums, stock cooperatives, or similar units converted after April 10, 1979 for which no removal permit or vested right determination has been issued by the Board, and those created pursuant to Article XX of this Charter.

Section 1802. *Integrity and Autonomy of Board.* The Rent Control Board shall be an integral part of the government of the City, but shall exercise its powers and duties under this Article independent of and without interference from the City Council, City Manager, and City Attorney. With respect to the internal organization and affairs of the Board:

(a) *Budget.* The Board shall, prior to July 1 of each year, hold a public hearing on a proposed budget and adopt an annual budget for the ensuing fiscal year. At least thirty-five days prior to the beginning of each fiscal year, the Board's administrator shall submit to the Board the proposed budget as prepared by him or her. After reviewing the same and making such revisions as it may deem advisable, the Board shall determine the time for the holding of a public hearing thereon and shall cause to be published a notice thereof not less than ten days prior to said hearing, by at least one insertion in the official newspaper. Copies of the proposed budget shall be available for inspection by the public in the office of the Board at least ten days prior to said hearing. The City Council and the City Manager shall have no authority to oversee, supervise, or approve this budget. Upon final adoption, the budget shall be in effect for the ensuing fiscal year and the amounts stated therein shall be and become appropriated by the Board for the respective objects and purposes therein specified. At any meeting after the adoption of the budget the Board may amend or supplement the budget by the affirmative votes of at least three

members. Copies of the adopted budget and any amendments or supplements shall be filed with the City Clerk, City Controller, and City Manager. Necessary adjustments to City administrative procedures shall be made.

(b) *Personnel.* Except for the elected or appointed Commissioners, the Administrator, and attorneys employed to represent or advise the Board, all employees of the Board are within the classified civil service of the City. The Board shall appoint an Administrator to administer and supervise the exercise of its powers and duties who shall be directly responsible to the Board. All employees of the Board, except the Administrator and attorneys, shall be hired, terminated, suspended, and demoted in accordance with the provisions of Article XI of the Charter and implementing provisions of the Municipal Code. The Board shall classify employee positions, establish employee salaries and benefits, evaluate the performance of its employees, and be responsible for the layoff and recall of its employees, pursuant to regulations and procedures that it establishes. The Board may enter into and approve a Memorandum of Understanding with representatives of its employees concerning their wages, benefits, hours of work, and terms and conditions of employment in accordance with state law. The City Council shall have no power to abolish positions established or classified by the Board under this Article, notwithstanding any other section of this Charter. Provisions of the Municipal Code and other ordinances or resolutions of the City Council shall not limit the Board's power to adopt regulations and policies and to approve Memorandums of Understanding governing its relationship with its employees under this Section.

(c) *Board Legal Work.* Legal staff hired by the Board shall represent and advise the Board, its Commissioners, and its staff in any civil matters, actions, or proceedings

in which the Board, its Commissioners, or its staff, in or by reason of their official capacity, are concerned or are a party. The Board may, in its sole discretion, and without approval of the City Council, retain private attorneys to furnish legal advice or representation in particular matters, actions or proceedings.

(d) *Contracts and Purchases.* The Board shall comply with the provisions of the City Charter providing for a centralized purchasing system and competitive bidding, and shall procure goods and services as do other City agencies. Provided, however, that the Board shall have sole and final authority to employ attorneys, legislative lobbyists, and other professionals, and to approve contracts for such professional services.

(e) *Conforming Regulations.* If any portion of this Article is declared invalid or unenforceable by decision of a court of competent jurisdiction or rendered invalid or unenforceable by state or federal legislation, the Board and not the City Council shall have authority to enact replacement regulations consistent with the intent and purpose of the invalidated provision and applicable law. Such replacement regulations shall supercede invalidated or unenforceable provisions of this Article to the extent necessary to resolve any inconsistency. The subject matter of such replacement regulations shall be limited to rent control matters as enumerated in this Article.

Section 1803. *Permanent Rent Control Board.*

(a) *Composition:* There shall be in the City of Santa Monica a Rent Control Board. The Board shall consist of five elected Commissioners. The Board shall elect annually as chairperson, one of its members to serve in that capacity.

(b) *Eligibility:* Duly qualified electors of the City of Santa Monica are eligible to serve as Commissioners of the Board.

(c) *Full Disclosure of Holdings:* Candidates for the position of Commissioner shall submit a verified statement listing all of their interests and dealings in real property, including but not limited to its ownership, sale or management, during the previous three (3) years.

(d) *Election of Commissioners:* Commissioners shall be elected at general municipal elections in the same manner as set forth in Article XIV of the Santa Monica Charter, except that the first Commissioners shall be elected at a special municipal election held within ninety (90) days of the adoption of this Article. The elected Commissioners shall take office on the first Tuesday following their election.

(e) *Term of Office:* Commissioners shall be elected to serve terms of four years, beginning on the first Tuesday following their election, except that of the first five Commissioners elected in accordance with Section 1803(d), the two Commissioners receiving the most votes shall serve until April 15, 1985 and the remaining three Commissioners shall serve until April 18, 1983. Commissioners shall serve a maximum of two full terms.

(f) *Powers and Duties:* The Board shall have the following powers and duties:

(1) Set the rent ceilings for all controlled rental units.

(2) Require registration of all controlled rental units under Section 1803(q).

(3) Establish a base rent ceiling on rents under Section 1804(b).

(4) To made adjustments in the rent ceiling in accordance with Section 1805.

(5) Set rents at fair and equitable levels in order to achieve the intent of this Article.

(6) Hire and pay necessary staff, including hearing examiners and personnel to issue orders, rules and regulations, conduct hearings and charge fees as set forth below.

(7) Make such studies, surveys and investigations, conduct such hearings, and obtain such information as is necessary to carry out its powers and duties.

(8) Report annually to the City Council of the City of Santa Monica on the status of controlled rental housing.

(9) Remove rent controls under Section 1803(r).

(10) Issue permits for removal of controlled rental units from rental housing market under Section 1803(t).

(11) Administer oaths and affirmations and subpoena witnesses.

(12) Establish rules and regulations for deducting penalties and settling civil claims under Section 1809.

(13) Refer violations of this Article to appropriate authorities for criminal prosecution.

(14) Seek injunctive and other civil relief under Section 1811.

(15) Charge and collect registration fees, including penalties for late payments.

(g) *Rules and Regulations:* The Board shall issue and follow such rules and regulations, including those which are contained in this Article, as will further the purposes of the Article. The Board shall publicize its rules and regulations prior to promulgation in at least one newspaper of general circulation in the City of Santa Monica. The Board shall hold at least one (1) public hearing to consider the views of interested parties prior to the adoption of general adjustments of the decision to decontrol or reimpose control for any class of rental units under Section 1803(r). All rules and regulations, internal staff memoranda, and written correspondence explaining the decisions, orders, and policies of the Board shall be kept in the Board's office and shall be available to the public for inspection and copying. The Board shall publicize this Article so that all residents of Santa Monica will have the opportunity to become informed about their legal rights and duties under Rent Control in Santa Monica. The Board shall prepare a brochure which fully describes the legal rights and duties of landlords and tenants under Rent Control in Santa Monica. The brochure will be available to the public, and each tenant of a controlled rental unit shall receive a copy of the brochure from his or her landlord.

(h) *Meetings:* The Board shall hold such regularly scheduled meetings as are necessary to ensure the timely performance of its duties under this Article. All regular and special meetings shall be called and conducted in accordance with state law.

(i) *Quorum:* Three Commissioners shall constitute a quorum for the Board.

(j) *Voting:* The affirmative vote of three Commissioners of the Board is required for a decision, including all motions, regulations, and orders of the Board.

(k) *Compensation:* Each Commissioner shall receive for every meeting attended seventy-five dollars ($75.00), but in no event shall any Commissioner receive in any twelve month period more than forty-seven hundred and fifty dollars ($4,750) for services rendered.

(l) *Dockets:* The Board shall maintain and keep in its office all hearing dockets.

(m) *Vacancies:* If a vacancy shall occur on the Board, the Board shall within thirty (30) days appoint a qualified person to fill such a vacancy until the following municipal election when a qualified person shall be elected to serve for the remainder of the term.

(n) *Financing:* The Board shall finance its reasonable and necessary expenses by charging landlords annual registration fees in amounts deemed reasonable by the Board. The Board may direct that all or part of such fees may be passed through from landlords to tenants and may establish applicable conditions and procedures. The Board is also empowered to request and receive funding when and if necessary from any available source for its reasonable and necessary expenses.

(o) *Recall:* Commissioners may be recalled in accordance with the provisions of Article XIV of the Santa Monica Charter.

(p) *Staff:* The Board shall employ and pay such staff, including hearing examiners and inspectors, as may be necessary to perform its function efficiently in order to fulfill the purpose of this Article.

(q) *Registration:* Within sixty (60) days after the adoption of this Article, the Board shall require the registration of all controlled rental units, which shall be re-registered at times deemed appropriate by the Board. The initial registration shall include the rent in effect at the time on the date of the adoption of this Article, base

rent ceiling, the address of the rental unit, the name and address of the landlord, the housing services provided to the unit, a statement indicating all operating cost increases since the base rent ceiling date, and any other information deemed relevant by the Board. The Board shall require the landlord to report vacancies in the controlled rental units and shall make a list of vacant controlled rental units available to the public. If the Board, after the landlord has proper notice and after a hearing, determines that a landlord has wilfully and knowingly failed to register a controlled rental unit, the Board may authorize the tenant of such a non-registered controlled rental unit to withhold all or a portion of the rent for the unit until such time as the rental unit is properly registered. After a rental unit is properly registered, the Board shall determine what portion, if any, of the withheld rent is owed to the landlord for the period in which the rental unit was not properly registered. Whether or not the Board allows such withholding, no landlord who has failed to register properly shall at any time increase rents for a controlled rental unit until such units are properly registered.

(r) *Decontrol:* If the average annual vacancy rate in any category, classification, or area of controlled rental units exceeds five (5) percent, the Board is empowered, at its discretion and in order to achieve the objectives of this Article, to remove rent controls from such category, classification or area. The Board may determine such categories, classifications, or areas for purposes of decontrol consistent with the objectives of this Article. In determining the vacancy rate for any category, classification or area of controlled rental units, the Board shall consider all available data and shall conduct its own survey. If units are decontrolled pursuant to this subsection, controls shall be reimposed if the Board finds that the average annual vacancy rate has thereafter fallen

below five (5) percent for such category, classification or area.

(s) *Security Deposits:* Any payment or deposit of money the primary function of which is to secure the performance of a rental agreement or any part of such agreement, including an advance payment of rent, shall be placed in an interest bearing account at a federally insured financial institution until such time as it is returned to the tenant or entitled to be used by the landlord. Unless and until the Board enacts regulations directing that the interest on such accounts be paid directly to the tenant, the landlord may either pay such interest directly to the tenant or use it to offset operating expenses, in which case the offset shall be a factor in making individual rent adjustments under Section 1805. The Board may regulate the amount and use of security deposits consistent with the purposes of this Article and state law.

(t) *Removal of Controlled Unit From Rental Housing Market:*

(1) Any landlord who desires to remove a controlled rental unit from the rental housing market by demolition, conversion or other means is required to obtain a permit from the Board prior to such removal from the rental housing market in accordance with rules and regulations promulgated by the Board. In order to approve such a permit, the Board is required to find that the landlord cannot make a fair return by retaining the controlled rental unit.

(2) Notwithstanding the foregoing provisions of this subsection, the Board may approve such a permit:

(i) If the Board finds that the controlled rental unit is uninhabitable and is incapable of being

made habitable in an economically feasible manner, or

(ii) If the permit is being sought so that the property may be developed with multifamily dwelling units and the permit applicant agrees as a condition of approval, that the units will not be exempt from the provisions of this Article pursuant to Section 1801(c) and that at least fifteen (15) percent of the controlled rental units to be built on the site will be at rents affordable by persons of low income.

(3) The Housing Element of the General Plan of the City of Santa Monica shall at all times contain a provision that neither the City Council nor any City agency shall approve an application for tentative subdivision map or tentative parcel map for a converted unit until and unless the applicant first obtains a removal permit as required by this Section. This subsection shall not apply to any tentative subdivision map or tentative parcel map approved in accordance with Article XX relating to tenant ownership rights.

(4) The Board shall render its final decision within one hundred and twenty (120) days of the filing of a completed application under this section.

Section 1804. *Maximum Allowable Rents.*

(a) *Temporary Freeze:* Rents shall not be increased during the one-hundred-twenty (120) day period following the date of adoption of this Article.

(b) *Establishment of Base Rent Ceiling:* Beginning one-hundred-twenty days after the adoption of this Article, no landlord shall charge rent for any controlled rental units in an amount greater than the rent in effect on the date one year prior to the adoption of this Article. The

rent in effect on that date is the base rent ceiling and is a reference point from which fair rents shall be adjusted upward or downward in accordance with Section 1805. If there was no rent in effect on the date one year prior to the adoption of this Article, the base rent ceiling shall be the rent that was charged on the first date that rent was charged following the date one year prior to the adoption of this Article.

(c) *Posting:* As soon as the landlord is aware of the maximum allowable rent, the landlord shall post it for each unit in a prominent place in or about the affected controlled rent units. The Board may require that other information it deems relevant also be posted.

Section 1805. *Individual and General Adjustment of Ceilings on Allowable Rents.*

(a) *General Adjustment:* The Board may, after holding those public hearings prescribed by Section 1803(g), set and adjust upward or downward the rent ceiling for all controlled rental units in general and/or for particular categories of controlled rental units deemed appropiate by the Board. Such an adjustment, however, need not take effect immediately, and the Board may decide that new rent ceilings shall not take effect until some reasonable date after the above-stated time periods.

(b) *Annual General Adjustment:* Each year the Board shall generally adjust rents as follows:

(1) Adjust rents upward by granting landlords a utility and tax increase adjustment for actual increases in the City of Santa Monica for taxes and utilities.

(2) Adjust rents upward by granting landlords a maintenance increase adjustment for actual increases in the City of Santa Monica for maintenance expenses.

(3) Adjust rents downward by requiring landlords to decrease rents for any actual decreases in the City of Santa Monica for taxes.

In adjusting rents under this subsection, the Board shall adopt a formula of general application.

(c) *Petitions:* Upon receipt of a petition by a landlord and/or a tenant, the maximum rent of individual controlled rental units may be adjusted upward or downward in accordance with the procedures set forth elsewhere in this Section. The petition shall be on the form provided by the Board and shall include a declaration by the landlord that the unit meets all requirements of Section 1805(h). Notwithstanding any other provision of this Section, the Board or hearing examiner may refuse to hold a hearing and/or grant a rent adjustment if an individual hearing has been held and decision made with regard to maximum rent within the previous six months.

(d) *Hearing Procedure:* The Board shall enact rules and regulations governing hearings and appeals of individual adjustment of ceilings on allowable rents which shall include the following:

(1) *Hearing Examiner:* A hearing examiner appointed by the Board shall conduct a hearing to act upon the petition for individual adjustment of ceilings on allowable rents and shall have the power to administer oaths and affirmations.

(2) *Notice:* The Board shall notify the landlord if the petition was filed by the tenant, or the tenant, if the petition was filed by the landlord, of the receipt of such a petition and a copy thereof.

(3) *Time of Hearing:* The hearing officer shall notify all parties, as to the time, date and place of the hearing.

(4) *Records:* The hearing examiner may require either party to a rent adjustment hearing to provide it with any books, records and papers deemed pertinent in addition to that information contained in registration statements. The hearing examiner shall conduct a current building inspection and/or request the City to conduct a current building inspection if the hearing examiner finds good cause to believe the Board's current information does not reflect the current condition of the controlled rental unit. The tenant may request the hearing examiner to order such an inspection prior to the date of the hearing. All documents required under this Section shall be made available to the parties involved prior to the hearing at the office of the Board. In cases where information filed in a petition for rent ceiling adjustment or in additional submissions filed at the request of the hearing examiner is inadequate or false, no action shall be taken on said petition until the deficiency is remedied.

(5) *Open Hearings:* All rent ceiling adjustment hearings shall be open to the public.

(6) *Right of Assistance:* All parties to a hearing may have assistance in presenting evidence and developing their position from attorneys, legal workers, recognized tenant organization representatives or any other persons designated by said parties.

(7) *Hearing Record:* The Board shall make available for inspection and copying by any person an official record which shall constitute the exclusive record for decision on the issues at the hearing. The record of the hearing, or any part of one, shall be obtainable for the cost of copying. The record of the hearing shall include: all exhibits, papers and documents required to be filed or accepted into evidence

during the proceedings; a list of participants present; a summary of all testimony accepted in the proceedings; a statement of all materials officially noticed; all recommended decisions; orders and/or rulings; all final decisions, orders and/or rulings, and the reasons for each final decision, order and/or ruling. Any party may have the proceeding tape recorded or otherwise transcribed at his or her own expense.

(8) *Quantum of Proof and Notice of Decision:* No individual adjustment shall be granted unless supported by the preponderance of the evidence submitted at the hearing. All parties to a hearing shall be sent a notice of the decision and a copy of the findings of fact and law upon which said decision is based. At the same time, parties to the proceeding shall also be notified of their right to any appeal allowed by the Board and/or to judicial review of the decision pursuant to this Section and Section 1808 of this Article.

(9) *Consolidation:* All landlord petitions pertaining to tenants in the same building will be consolidated for hearing, and all petitions filed by tenants occupying the same building shall be consolidated for hearing unless there is a showing of good cause not to consolidate such petitions.

(10) *Appeal:* Any person aggrieved by the decision of the hearing examiner may appeal to the Board. On appeal, the Board shall affirm, reverse or modify the decision of the hearing examiner. The Board may conduct a de novo hearing or may act on the basis of the record before the hearing examiner without holding a hearing.

(11) *Finality of Decision:* The decision of the hearing examiner shall be the final decision of the

Board in the event of no appeal to the Board. The decision of the hearing examiner shall not be stayed pending appeal; however, in the event that the Board on appeal reverses or modifies the decision of the hearing examiner, the landlord, in the case of an upward adjustment in rent, or the tenant, in the case of a downward adjustment of rent, shall be ordered to make retroactive payments to restore the parties to the position they would have occupied had the hearing examiner's decision been the same as that of the Board.

(12) *Time for Decision:* The rules and regulations adopted by the Board shall provide for final action on any individual rent adjustment petition within one-hundred and twenty (120) days, following the date of filing of the individual rent adjustment petition.

(13) *Board Action in Lieu of Reference to Hearing Examiner:* The Board, on its own motion or on the request of any landlord or tenant, may hold a hearing on an individual petition for rent adjustment without the petition first being heard by a hearing examiner.

(14) Decisions decreasing rents shall remain in effect until the Board finds that the landlord has corrected the defect warranting the decrease. The Board shall, by regulation, establish procedures for making prompt compliance determinations. Upon a determination of compliance the landlord shall be entitled to reinstatement of the prior rent level, retroactive to the date that the landlord corrected the defect which warranted the decrease.

(e) In making individual and general adjustments of the rent ceiling, the Board shall consider the purposes of this Article and the requirements of law. The Board may

adopt as its fair return standard any lawful formula, including but not limited to one based on investment or net operating income. The Board shall consider all factors relevant to the formula it employs; such factors may include: increases or decreases in operating and maintenance expenses, the extent of utilities paid by the landlord, necessary and reasonable capital improvement of the controlled rental unit as distinguished from normal repair, replacement and maintenance, increases or decreases in living space, furniture, furnishings, equipment, or services, substantial deterioration of the controlled rental unit other than as a result of ordinary wear and tear, failure on the part of the landlord to provide adequate housing services or to comply substantially with applicable housing, health and safety codes, federal and state income tax benefits, the speculative nature of the investment, whether or not the property was acquired or is held as a long term or short term investment, the landlord's rate of return on investment, the landlord's current and base date Net Operating Income, and any other factor deemed relevant by the Board in providing the landlord a fair return.

(f) No rent increase shall be authorized by this Article because a landlord has a negative cash flow as the result of refinancing the controlled rental unit if at the time the landlord refinanced the landlord could reasonably have foreseen a negative cash flow based on the rent schedule then in existence within the one year period following refinancing. This paragraph shall only apply to that portion of the negative cash flow reasonably foreseeable within the one year period following refinancing of the controlled rental unit and shall only apply to controlled rental units refinanced after the date of adoption of this Article.

(g) No rent increase shall be authorized by this Article because a landlord has a negative cash flow if at the time the landlord acquired the controlled rental unit, the landlord could reasonably have foreseen a negative cash flow based on the rent schedule then in existence within the one year period following acquisition. This paragraph shall only apply to that portion of the negative cash flow reasonably foreseeable within the one year period following acquisition of a controlled rental unit and shall only apply to controlled rental units acquired after the date of adoption of this Article.

(h) No landlord shall increase rent under this Article if the landlord:

(1) Has failed to comply with any provision of this Article and/or regulations issued thereunder by the Board, including the provisions requiring the payment of registration fees and registration penalties.

(2) Has failed to comply substantially with any applicable state or local housing, health or safety law. No landlord shall increase rent unless the notice increasing rent contains a statement in substantially the following form: "The undersigned (landlord) certifies that this unit and common areas are not subject to any uncorrected citation or notices of violation of any state or local housing health, or safety laws issued by any government official or agency." If a landlord fails to comply with this subsection, the tenant may refuse to pay the improperly noticed increase, may seek administrative or civil remedies under this Article, and may raise the landlord's noncompliance as an affirmative defense in any resulting unlawful detainer action.

(i) The Board may, in its discretion, enact regulations to provide for increases of rents on units voluntarily vacated after the effective date of this subsection in properties where the landlord has dedicated a percentage of units to be rented to persons of very low or low income at affordable rents. The Board may enact procedures and other regulations governing determination of the conditions upon which such increases will be permitted, the extent of the increases, the required mix of affordable units to be provided, ways to ensure the continued provision of affordable housing under this subsection, the terms and conditions applicable when landlords cease to participate or when tenants vacate or cease to qualify for units dedicated to affordable housing, and other measures it deems necessary.

If the Board enacts regulations under this subsection, it shall provide for the following:

(1) That a property shall not be eligible for this program unless a specified percentage of all units on the property, no less than fifteen (15) percent, will be occupied by tenants of very low or low income and the rent on each unit so occupied does not exceed a specified percentage, no greater than thirty (30) percent, of such tenants' income.

(2) That tenants of very low or low income occupying units maintained at affordable rent levels under this program are protected if the landlord elects not to participate further in the program. Such protection shall include, at a minimum, a provision prohibiting the rent of such tenants from being increased by a percentage greater than the general annual adjustment allowed by the Board even if the resulting rent is below the maximum allowable rent and the landlord has lowered the rent for other units on the property.

Section 1806. *Eviction.* No landlord shall take action to terminate any tenancy including service of any notice to quit or other eviction notice or bring any action to recover possession or be granted recovery of possession of a controlled rental unit unless:

(a) The tenant has failed to pay the rent to which the landlord is entitled under the rental housing agreement and this Article.

(b) The tenant has violated an obligation or covenant of his or her tenancy other than the obligation to surrender possession upon proper notice and has failed to cure such violation after having received written notice thereof from the landlord in the manner required by law.

(c) The tenant is committing or expressly permitting a nuisance in, or is causing substantial damage to, the controlled rental unit, or is creating a substantial interference with the comfort, safety, or enjoyment of the landlord or other occupants or neighbors of the same.

(d) The tenant is convicted of using or expressly permitting a controlled rental unit to be used for any illegal purpose.

(e) The tenant, who had a rental housing agreement which had terminated, has refused, after written request or demand by the landlord, to execute a written extension or renewal thereof for a further term of like duration and in such terms as are not inconsistent with or violative of any provisions of this Article and are materially the same as in the previous agreement.

(f) The tenant has refused the landlord reasonable access to the controlled rental unit for the purposes of making necessary repairs or improvements required by the laws of the United States, the State of California or any subdivision thereof, or for the purpose of showing the rental housing to any prospective purchaser or mortgagee.

(g) The tenant holding at the end of the term of the rental housing agreement is a sub-tenant not approved by the landlord.

(h) The landlord seeks to recover possession in good faith for use and occupancy by herself or himself, or her or his children, parents, grandparents, brother, sister, father-in-law, mother-in-law, son-in-law, or daughter-in-law. For purposes of evictions under this subsection:

(1) A "landlord" shall be defined as a natural person who has at least a fifty (50) percent ownership interest in the property.

(2) No eviction may take place if any landlord or enumerated relative already occupies one unit on the property, or if a vacancy already exists on the property and the vacant unit is comparable to the unit for which eviction is sought. Where the vacant unit is determined not to be comparable, thereby permitting eviction under this subsection, the evicted tenant or tenants shall be first given the right to occupy the vacant unit and the rent thereof shall be the lesser of the maximum allowable rent for the vacant unit and the maximum allowable rent of the unit from which the tenant or tenants are evicted. The Rent Control Board shall promulgate regulations defining when a unit is comparable for purposes of this paragraph.

(3) The notice terminating tenancy shall contain the name, address and relationship to the landlord of the person intended to occupy.

(4) The landlord or enumerated relative must intend in good faith to move into the unit within thirty (30) days after the tenant vacates and to occupy the unit as a primary residence for at least one year. The Board may adopt regulations governing the determination of good faith.

(5) If the landlord or relative specified on the notice terminating tenancy fails to occupy the unit within thirty (30) days after the tenant vacates, the landlord shall:

(i) Offer the unit to the tenant who vacated it.

(ii) Pay to said tenant all reasonable expenses incurred in moving to and/or from the unit.

(6) No eviction pursuant to this subsection shall be allowed in any condominium or stock cooperative unit which has been converted from an apartment or other rental unit after April 10, 1979, unless the Rent Control Board has issued a removal permit or declared a vested right for said unit. As used in this subpart, a unit shall be deemed converted after April 10, 1979, if on April 10, 1979, the recorded tract map or parcel map for the property showed the unit as included in the property.

(i) The landlord seeks to recover possession to demolish or otherwise remove the controlled rental unit from rental residential housing use after having obtained all proper permits from the City of Santa Monica.

Notwithstanding the above provisions, possession shall not be granted if it is determined that the eviction is in retaliation for the tenant reporting violations of this Article, for exercising rights granted under this Article, including the right to withhold rent upon authorization of the Board under Section 1803(q) or Section 1809 or for organizing other tenants. In any notice purporting to terminate tenancy the landlord shall state the cause for the termination, and in any action brought to recover possession of a controlled rental unit, the landlord shall allege and prove compliance with this Section.

Any violation of this Section shall render the landlord liable to the tenant in a civil action for actual and punitive damages. The prevailing party in an action based upon this Section shall recover costs and attorney's fees.

Section 1807. *Non-waiverability:* Any provision, whether oral or written in or pertaining to a rental housing agreement whereby any provision of this Article for the benefit of the tenant is waived, shall be deemed to be against public policy and shall be void.

Section 1808. *Judicial Review:* A landlord or tenant aggrieved by any action or decision of the Board may seek judicial review by appealing to the appropriate court within the jurisdiction.

Section 1809. *Civil Remedies:*

(a) Any landlord who demands, accepts, receives, or retains any payment of rent in excess of the maximum lawful rent, in violation of the provisions of this Article or any rule, regulation or order hereunder promulgated, including the provisions ensuring compliance with habitability standards and registration fee requirements, shall be liable in a civil action to the tenant from whom such payments are demanded, accepted, received or retained,

for reasonable attorney's fees and costs as determined by the court, plus damages in the amount by which the payment or payments demanded, accepted, received or retained exceeds the maximum lawful rent. A civil penalty of treble the amount by which the payment or payments demanded, accepted, received or retained exceeds the maximum lawful rent shall be awarded against the landlord upon a showing that the landlord has acted willfully or with oppression, fraud or malice. No administrative remedy need be exhausted prior to filing suit pursuant to this subsection.

(b) In lieu of filing a civil action, a tenant may file an administrative complaint. The Board shall establish by rule and regulation a hearing procedure similar to that set forth in Section 1805(d).

(1) The rules and regulations adopted by the Board shall provide for final Board action on any complaint for excess rent within one-hundred and twenty (120) days following the date of filing of the complaint.

(2) In any administrative hearing under this Section, a landlord who demands, accepts, receives or retains any payment of rent in excess of the maximum lawful rent shall be liable for damages in the amount by which the payment or payments demanded, accepted, received or retained exceeds the maximum lawful rent and may be liable for an additional amount not to exceed Five Hundred Dollars ($500), for costs, expenses incurred in pursuing the hearing remedy, damages and penalties. The tenant shall bear the burden of proving entitlement to the penalty. The tenant may deduct the penalty and award of damages from future rent payments in the manner provided by the Board. An order authorizing rent withholding under this Article shall survive the

sale or other transfer of the property and shall be binding upon successors of the landlord against whom the order was made. If a tenant authorized to withhold rent under this Article vacates the property, the landlord shall pay to such tenant a sum equal to the balance of the rent that the tenant could have withheld.

(c) If the tenant from whom such excessive payment is demanded, accepted, received or retained in violation of the foregoing provisions of this Article or any rule or regulation or order hereunder promulgated fails to bring a civil or administrative action as provided for in Section 1809(a) and 1809(b) within one hundred and twenty (120) days from the date of occurrence of the violation, the Board may settle the claim arising out of the violation or bring such action. Thereafter, the tenant on whose behalf the Board acted is barred from also bringing an action against the landlord in regard to the same violation for which the Board has made a settlement or brought action. In the event the Board settles said claim, it shall be entitled to retain the costs it incurred in settlement thereof, and the tenant against whom the violation has been committed shall be entitled to the remainder.

(d) The appropriate court in the jurisdiction in which the controlled rental unit affected is located shall have jurisdiction over all actions brought under this Section.

Section 1810. *Criminal Remedies.* Any landlord violating this Article shall be guilty of a misdemeanor. Any landlord convicted of a misdemeanor under the provisions of this Article shall be punished by a fine of not more than five hundred dollars ($500) or by imprisonment in the county jail for a period not exceeding six months, or by both such fine and imprisonment.

Section 1811. *Injunctive and Other Civil Relief.* The Board, and tenants and landlords of controlled units, may seek relief from the appropriate court within the jurisdiction within which the affected controlled rental unit is located to enforce any provision of this Article or its implementing regulations or to restrain or enjoin any violation of this Article and of the rules, regulations, orders and decisions of the Board.

Section 1812. *Partial Invalidity.* If any provision of this Article or application thereof to any person or circumstances is held invalid, this invalidity shall not affect other provisions or applications of this Article which can be given effect without the invalid provision or application, and to this end the provisions of this Article are declared to be severable. This Article shall be liberally construed to achieve the purposes of this Article and to preserve its validity.

Section 1813. *Relationship to Article XX.* Section 1803(t) of this Article shall not apply to any building for which approval has been received pursuant to Article XX (Tenant Ownership Rights Charter Amendment) of this Charter. All other provisions of this Article, however, shall continue to apply with full force and effect to each unit in any building receiving approval pursuant to Article XX. Tenants residing in such units, whether or not "qualifying," "participating," or any other such designation under Article XX, shall enjoy all the rights and remedies provided by this Article without limitation as to duration or to ownership of the unit. This Section is declarative of existing law and does not impose any new requirements or limit any existing ones.

Section 1814. *Existing Board Practices.* To the extent that the amendments to Article XVIII adopted at the same time as this Section incorporate rules, regulations and practices of the Rent Control Board existing on the

date of the adoption hereof, this amendment is declarative of existing law and does not impose any new requirements or limit any existing ones.

Section 1815. *Single Family Homes.* Single Family homes that were used for residential purposes on July 1, 1984 are automatically exempt from the provisions of this Article. Single family homes that are not exempt under the preceding sentence are subject to all requirements of this Article, but shall be permanently exempted by the Board upon proof that the home has been continuously occupied by the owner for a period of two years as a principal place of residence after voluntary vacancy by the tenant or lawful eviction of the tenant. An owner may have only one exemption under this Section at any one time.

ORDINANCE NUMBER 1255(CCS)

(City Council Series)

AN ORDINANCE OF THE CITY COUNCIL OF THE CITY OF SANTA MONICA ESTABLISHING STANDARDS AND PROCEDURES FOR THE REMOVAL OF CONTROLLED RENTAL UNITS AND DECLARING THE PRESENCE OF AN EMERGENCY

THE CITY COUNCIL OF THE CITY OF SANTA MONICA DOES ORDAIN AS FOLLOWS:

SECTION 1. **Findings and Purpose.** The City Council finds and declares:

(a) On April 10, 1979, the voters adopted the Santa Monica Rent Control Charter Amendment adding Article XVIII to the City Charter of the City of Santa Monica.

(b) The Santa Monica Rent Control Charter Amendment provides tenants in the City of Santa Monica with protection from unjustified rent increases, unjustified evictions, and the unnecessary removal of rental units by condominium conversion, demolition, and other means.

(c) Section 1803(t) of the Santa Monica Rent Control Charter Amendment requires that a removal permit be granted by the Santa Monica Rent Control Board in order to remove any controlled rental unit from the rental housing market.

(d) The City Council takes legislative notice of the case of *Baker v. City of Santa Monica*, Los Angeles Superior Court, Case Number WEC 58763 and Case Number WEC 59251, and the documentary and oral testimony given therein.

(e) As a result of the Superior Court decision in the case of *Baker v. City of Santa Monica*, Section 1803(t) of the

Santa Monica Rent Control Charter Amendment has been declared unconstitutional in certain respects.

(f) The Superior Court has directed the City Council to adopt an appropriate replacement ordinance on or before August 18, 1982.

(g) The City Council readopts and reaffirms the findings made by the voters in adopting the Santa Monica Rent Control Charter Amendment.

(h) The City Council finds and declares that standards and procedures for the removal of controlled rental units are necessary to preserve the rental housing stock and to effectuate the purposes of the Santa Monica Rent Control Charter Amendment.

(i) The City intends to appeal the Superior Court decision in *Baker v. City of Santa Monica* and pending resolution of the appeal it is necessary to protect the rental housing stock.

(j) In the absence of standards and procedures for the removal of controlled rental units, state and local housing goals and policies would be frustrated by the demolition of rental units and displacement of low and moderate income tenants.

SECTION 2. **Removal of Controlled Rental Units.**

(a) Any landlord of a controlled rental unit, as that term is defined in Section 1801(c) of the City Charter, who desires to remove such rental unit from the rental housing market by demolition, conversion or other means is required to obtain in addition to any other permits required by law a permit from the Santa Monica Rent Control Board prior to such removal from the rental housing market in accordance with rules and regulations promulgated by the Board.

(b) The regulations promulgated by the Santa Monica Rent Control Board shall require that a removal permit be granted if the Santa Monica Rent Control Board determines that the landlord cannot make a fair return as constitutionally

defined by retaining the controlled rental units on the rental housing market. The Board shall determine that a landlord cannot make a fair return if it makes one of the following findings:

(1) The landlord is unable to rent the unit at the rent established by the Santa Monica Rent Control Board as the Maximum Allowable Rent for the controlled rental unit.

(2) The Maximum Allowable Rent established by the Santa Monica Rent Control Board for the controlled rental unit does not provide the landlord with a fair return and the landlord would be unable to rent the unit at that rent level necessary to provide a fair return.

(3) The controlled rental unit is uninhabitable and cannot be made habitable in an economically feasible manner.

(c) Notwithstanding subdivision (b), the Santa Monica Rent Control Board may grant a removal permit if the permit is being sought so that the property may be developed with rental units and the permit applicant agrees as a condition of approval that the units to be constructed on the property will not be exempt from the provisions of Article XVIII of the City Charter and at least 15 percent of the controlled rental units to be built on the property will be at rents affordable to persons of low and moderate income.

(d) The Santa Monica Rent Control Board shall promulgate rules and regulations to implement this Section.

(e) The City Council and the Santa Monica Rent Control Board shall review at least every six months the implementation of this Section in order to assure that action is being taken consistent with this Section and with the Superior Court decision in *Baker v. City of Santa Monica.*

SECTION 3. **Effective Date and Expiration**. This ordinance shall take effect and be in full force immediately after the passage and adoption thereof and shall be of no further effect and shall be deemed repealed upon a final court decision of the California Court of Appeal, California

Supreme Court, or United States Supreme Court determining that Section 1803(t) of the City Charter is constitutional and may be enforced by the Santa Monica Rent Control Board.

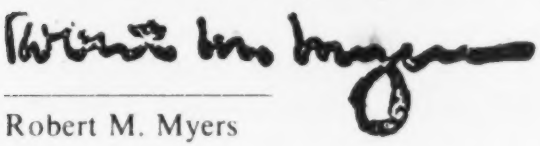
SECTION 4. **Inconsistent Provisions.** Any provision of the Santa Monica Municipal Code or appendices thereto inconsistent with the provisions of this ordinance, to the extent of such inconsistencies and no further, are hereby repealed or modified to that extent necessary to affect the provisions of this ordinance.

SECTION 5. **Severability.** If any section, subsection, sentence, clause, or phrase of this ordinance is for any reason held to be invalid or unconstitutional by a decision of any court of any competent jurisdiction, such decision shall not affect the validity of the remaining portions of the ordinance. The City Council hereby declares that it would have passed this ordinance and each and every section, subsection, sentence, clause or phrase not declared invalid or unconstitutional without regard to whether any portion of the ordinance would be subsequently declared invalid or unconstitutional.

SECTION 6. **Emergency**. This ordinance is declared to be an emergency measure adopted pursuant to the provisions of Section 615 of the City Charter and is necessary for preserving the public peace, health, and safety, and the urgency for its adoption is set forth in the findings above.

SECTION 7. **Execution**. The Mayor shall sign and the City Clerk shall attest to the passage of this ordinance. The City Clerk shall cause the same to be published once in the official newspaper within 15 days after its adoption.

APPROVED AS TO FORM:



Robert M. Myers
City Attorney

4040. Fair Return on Investment.

(a) **Definitions.** For purposes of individual rent adjustment proceedings, the following definitions shall be used:

(1) **Investment.** Investment is the total of cash or cash equivalent down payment, accrued principal payments, unamortized capital improvements, and any cash expenses incurred in the ownership and operation of the building to the extent that such expenses exceed the income from the property.

(2) **Acquisition.** A property is acquired at the time it is conveyed from the grantor to the grantee. In the case of a landlord who is purchasing the property pursuant to a land sale contract that provides for title to be passed at a date later than the date on which the contract is signed, the property shall be deemed acquired on the date on which the land sale contract or memorandum of same is recorded or the date on which the deed conveying title is recorded, whichever occurs first.

(3) **Speculative Purchase.**

(i) A purchase which assumes an unusual business risk in expectation of profiting from market fluctuations.

(ii) In determining whether or not any purchase of property was speculative, all relevant factors shall be explored including, but not limited to, the purchase price, the types, terms, number, and sources of financing, the availability or non-availability of commercial financing, percentage of the purchase price that a commercial lender would have loaned, and the period of time that the landlord intended to hold the property before placing it on the market for resale.

(4) **Self-labor**. Self-labor includes all labor reasonably performed by the landlord in the operation of the building.

(5) **Refinancing Proceeds.** Any cash obtained by the landlord as a result of any refinancing arrangement, annualized over the life of the refinancing loan.

(6) **Gross Rent Multiplier.** The ratio of the purchase price to annual rents at 100% occupancy based upon the rent schedule in existence at the time of acquisition.

(Total Purchase Price) / (Annual Rents at 100% Occupancy)

(7) **Net Cash Flow Profit.** Net cash flow profit is the remainder of income after subtracting total expenses and total debt service from the total collected income.

(8) **Return on Investment.** Return on investment is an annual total of:

(i) Net cash flow profit;

(ii) Principal payments;

(iii) Tax benefits calculated pursuant to Section 4040(c); and

(iv) Refinancing proceeds.

(9) **Rate of Return on Investment.** Return on investment divided by investment.

(b) **Compensation for self-labor.** Self-labor will be compensated upon documentation being provided showing the date, time, and nature of the work performed, and shall be compensated at the following hourly rates:

Bookkeeping/ Management	$6.00
General Maintenance	$7.00
Skilled Labor	$13.00

Notwithstanding the above, a landlord may receive greater or lesser compensation for self-labor if it can be shown that the amounts set forth above are substantially unfair in a given case.

There shall be a maximum allowance of 5% of the total collected income as compensation for self-management.

(c) **Tax Benefits.**

(1) In the absence of evidence to the contrary, it shall be presumed that a landlord has net tax benefits from a building in an amount equal to 24% of the depreciation allowance for the property. This amount is based upon a taxpayer in the 40% tax bracket and takes into account recapture of tax savings at reduced capital gains rates at the time of sale of the property.

(2) In the absence of evidence to the contrary, it shall be presumed that the depreciation allowance for the structure shall be 75% of the purchase price divided by 25 years for buildings that were more than 5 years old at the time of acquisition and 35 years for buildings that were less than 5 years old at the time of acquisition.

(d) **Application of Sections 1805(f) and 1805(g).**

(1) Sections 1805(f) and 1805(g) are only applicable to property refinanced or acquired on or after April 10, 1979. A property is refinanced on the date that the promissory note or the deed of trust securing any financing is executed, whichever is first.

(2) A negative cash flow is foreseeable if at the time of refinancing or acquisition, the rent schedule then in effect was insufficient to cover the debt service and operating expenses which could have been foreseen within the one-year period following the refinancing or acquisition. The fact that an increase in debt service or operating expenses which is foreseeable according to the preceding sentence does not occur until the second year, or later, after the refinancing or acquisition does not allow the landlord to obtain a rent increase based on that expense under Section 1805(f) or 1805(g).

(e) **Fair Return.**

(1) **Presumption.** It shall be presumed that the rate of return on investment that the landlord was realizing on April 10, 1978 was a fair return on investment. It is the purpose of both the general and individual rent adjustment process to preserve this rate of return by granting rent increases to cover increases in various categories of expenses. The Board generally will not deny a rent increase requested by a landlord to cover increased expenses because the landlord has a return greater than that set in 4040(e)(3).

(2) **Overcoming the Presumption.** A landlord or tenant may attempt to rebut this presumption by showing that the rate of return that the landlord was realizing on April 10, 1978 is not a fair rate of return on investment. The longer the landlord held the property prior to April 10, 1978, the more difficult it will be to establish that the return was not fair since the rate of return had been established by the landlord in the private marketplace. Among the factors that shall be considered relevant in determining whether the rents in effect in any building on April 10, 1978 yielded a fair return are:

(i) Date of purchase;

(ii) Capital improvements made during or after 1978 but prior to April 10, 1979 that are neither reflected by the rents in effect on April 10, 1978 nor compensated by applicable general or individual adjustments.

(iii) Increases in property taxes and extraordinary unavoidable increases in operating expenses incurred during or after 1978 but prior to April 10, 1979 that are neither reflected by the rents in effect on April 10, 1978 nor compensated by applicable general or individual adjustments.

(iv) The fact, if proved, that rents in effect on April 10, 1978 reflect rent increases during 1978 that substantially exceed increases in taxes and unavoidable increases in operating expenses incurred during 1978 and amortization of capital improvements made during 1978.

(v) Any other factors tending to show that gross inequity and extreme hardship will result to the landlord or to the tenants if the rents in effect on April 10, 1978 are presumed to yield a fair return.

(3) **When the Presumption Is Overcome.** When a landlord rebuts the presumption in subparagraph 4040(e)(1), if the landlord is otherwise entitled to an increase, the Board or its hearing examiner shall grant an increase or schedule of increases in rent which will provide the landlord with a return on investment which will equal the four year average yield of AAA corporate bonds. This average will be the average for the four years prior to the year in which the petition for rent adjustment is filed.

(i) **Maximum Adjustment.** In no event shall any yearly increase given be greater than twice the increase of the Employment Cost Index (ECI) as measured by the United States Bureau of Labor Statistics for the twelve months preceding the date of the final Board decision.

(ii) **All Properties.** The time over which any increase allowable under the law will be scheduled shall be determined so as to do fairness among all parties, and shall be calculated after consideration of at least the following factors:

(A) The efficiency of the landlord's operation;

(B) The reason the increase is sought;

(C) The effect of the rent rollback and any negative cash flow;

(D) The speculative nature of the purchase; and

(E) Tenant hardship.

Where scheduling of rent increases requires projections of income and expenses, it shall be assumed that operating expenses will increase at 10% per year, that property taxes will increase at 2% per year, and that vacancy loss and bad debts will be 3% of total potential rental income. The purpose of these assumptions is to permit the calculation of the

appropriate net cash flow yield required at the end of the schedule.

(iii) **Pre-April 10, 1979 Acquisitions With Negative Cash Flows.** The degree to which a property is not yielding a positive net cash flow is dependent upon four factors: the total purchase price, the nature and terms of acquisition financing, the rental income, and total expenses. The interrelation of these factors significantly establishes the degree and expected duration of the negative net cash flow yield.

In making individual rent adjustments for these properties, the Board shall establish a schedule of rent increases to eliminate the negative cash flow. The duration of the schedule will be based upon the actual gross rent multiplier at the time the property was acquired.

The duration of the schedule shall be established as set forth below, subject to modification after consideration of factors set forth in Section 4040(e)(3)(ii).

Year to Yield Zero Net Cash Flow	Gross Rent Multiplier
2	7.0 - 8.9
3	9.0 - 10.9
4	11.0 - 12.9
5	13.0 or greater

(4) **Alteration of Schedule.** In the event that any extraordinary increases in expenses which were not anticipated at the time of the final decision of the Board on any petition occur during the period in which scheduled increases have been granted, the landlord may file a new petition setting forth such facts. Upon presentation of appropriate documentation at a hearing before a hearing examiner or the Board, the scheduled increases shall be altered accordingly.

(f) **Relationship of Individual Adjustments to the General Adjustment.** A landlord who is granted an individual rent adjustment under Section 4040 may not take advantage of any general rent adjustment until one year after the date of a final Board decision in which rents were increased pursuant to an individual rent adjustment. However, in those cases in which a schedule of rent increases are granted to take place over a period longer than one year, the landlord may not take advantage of any general rent adjustment until one year after the date on which the final rent increase is scheduled to take place.

SUBCHAPTER G. STANDARDS FOR DECISION

4100. Fair Return

It is the intent of this Regulation to establish rents at a level which will provide landlords with a fair return on their property, consistent with the Rent Control Charter Amendment (Santa Monica City Charter, Article XVIII).

4101. Definitions

For purposes of individual rent adjustment proceedings, the following definitions shall be used:

(a) Net Operating Income equals Gross Income less Operating Expenses.

(b) Gross Income equals the following:

(1) Gross Rents, computed as gross rental income at 100% paid occupancy, plus

(2) Interest from rental deposits, unless directly paid by the landlord to the tenants (interest shall be imputed at the rate of 5½% of all deposits unless such deposits earn greater interest), plus

(3) Income from laundry facilities, cleaning fees or services, garage and parking fees, plus

(4) All other income or consideration received or receivable for or in connection with the use or occupancy of rental units and housing services.

(5) Minus uncollected rents due to vacancy and bad debts to the extent that the same are beyond the landlord's control. Uncollected rents in excess of 3% of Gross Rents shall be presumed to be unreasonable unless established otherwise. Where uncollected rents must be estimated, the average of the preceding 3 years experience shall be used, or some other comparable method.

(c) Operating Expenses:

(l) Operating expenses shall include the following:

(i) Real Property taxes.

(ii) Utility costs.

(iii) Management expenses (contracted or owner performed), including necessary and reasonable advertising, accounting, insurance, and other managerial expenses, and Allowable Legal Expenses. Management expenses are presumed to be 5% of Gross Income, unless established otherwise.

(iv) Normal repair and maintenance expenses, including painting, normal cleaning, fumigation, landscaping, and repair of all standard services, including electrical, plumbing, carpentry, furnished appliances, drapes, carpets and furniture.

(v) Owner-performed labor, which shall be compensated at the following hourly rates upon documentation being provided showing the date, time, and nature of the work performed:

General Maintenance:	$7.00/hr.
Skilled labor:	$13.00/hr.

Notwithstanding the above, a landlord may receive greater or lesser compensation for self-labor if it can be shown that the amounts set forth above are substantially unfair in a given case.

There shall be a maximum allowance under this paragraph of 5% of Gross Income, unless the landlord shows greater services for the benefit of tenants.

(vi) License and registration fees required by law to the extent same are not otherwise paid by tenants.

(vii) Capital Expenses with a total cost of less than $100 per year per benefited unit, and the amortized portion of other Capital Expenses otherwise allowed by regulation.

(2) Operating Expenses shall not include:

(i) Avoidable and unnecessary expense increases since the base year;

(ii) Mortgage principal and interest payments;

(iii) Any penalties, fees or interest assessed or awarded for violation of this or any other law;

(iv) Legal fees except as provided in Subsection (d);

(v) Depreciation of the property;

(vi) Any expense for which the landlord has been reimbursed by any security deposit, insurance settlement, judgment for damages, settlement, or any other method.

(d) Allowable Legal Expenses shall include:

Attorney's fees and costs incurred in connection with successful good faith attempts to recover rents owing and successful good faith unlawful detainer actions not in derrogation of applicable law, to the extent same are not recovered from tenants. Attorney's fees and costs incurred in proceedings before the Board, or in connection with civil actions against the Board, are not allowable as Operating Expenses.

(e) Base Year for purposes of this Regulation shall mean calendar year, 1978.

(f) Consumer Price Index (CPI) is the CPI for All Urban Consumers for the Los Angeles, Long Beach, Anaheim Metropolitan Area (All Items), provided by the U.S. Bureau of Labor Statistics.

4102. **Presumption of Fair Base Year Net Operating Income**

Except as provided in §4103, it shall be presumed that the Net Operating Income produced by a property during the base year provided a fair return on property. Landlords shall be entitled to maintain and increase their Net Operating Income from year to year in accordance with §4106.

4103. **Rebutting the Presumption**

It may be determined that the base year Net Operating Income yielded other than a fair return on property, in which case, the base year Net Operating Income may be adjusted accordingly. In order to make such a determination, the Board or Hearing Examiner must make at least one of the following findings:

(a) The landlord's operating and maintenance expenses in the base year were unusually high or low in comparison to other years. In such instances, adjustments may be made in calculating such expenses so the base year Operating Expenses reflect average expenses for the property over a reasonable period of time. The Board or Hearing Examiner shall consider the following factors:

(1) The landlord made substantial capital improvements during 1978, which were not reflected in the rent levels on the base date;

(2) Substantial repairs were made due to damage caused by natural disaster or vandalism;

(3) Maintenance and repair was below accepted standards so as to cause significant deterioration in the quality of housing services;

(4) Other expenses were unreasonably high or low notwithstanding the following of prudent business practice. In making this determination, the fact that property taxes prior to 1978 may have been higher than in the base year shall not be considered.

(b) The rent on the base date was disproportionate due to one of the enumerated factors below. In such instances, adjustments may be made in calculating Gross Rents consistent with the purposes of this Chapter.

(1) The rent on the base date was established by a lease or other formal rental agreement which provided for substantially higher rent at other periods during the term of the lease;

(2) The rent on the base date was substantially higher or lower than at other times of the year by reason of seasonal demand or seasonal variations in rent;

(3) The rent on the base date was substantially higher or lower than preceding months by reason of premiums being charged or rebates being given for reasons unique to particular units or limited to the period determining the base rent.

(c) It shall be presumed that where Net Operating Income is less than 50% of Gross Income in the base year, after making adjustments as permitted by subsections (a) and (b) of this Section, the landlord was receiving less than a fair return on property. In such a case, for purposes of determining Base Year Net Operating Income, Gross Income shall be adjusted upward to twice the amount of adjusted Base Year Operating Expenses.

4104. **Determination of Base Year Net Operating Income**

(a) To determine the Net Operating Income during the base year, there shall be deducted from the annualized Gross Income being realized on April 10, 1978, a sum equal to the actual Operating Expenses for calendar year 1978, unless the landlord demonstrates to the satisfaction of the Board or Hearing Examiner that some other 12 consecutive month period is justified by reasons independent of the purpose of this Section. In all cases, April 10, 1978, shall fall within the 12 month period utilized herein, except as provided in Subsection (b).

(b) In the event that the landlord did not own the subject property on January 1, 1978, the Operating Expenses for 1978 shall be determined by one of the following manners, whichever the Board or Hearing Examiner determines to be more reliable in the particular case:

(1) The previous owner's actual Operating Expenses as defined in §4101(c); or, where unavailable,

(2) Actual Operating Expenses for the first calendar year of ownership, discounted to 1978 by the schedule in §4105.

4105. **Schedule of Increase In Operating Expense**

Where scheduling of rent increases or other calculations require projections of income and expenses, it shall be assumed that Operating Expenses, exclusive of Property Taxes and Management Expenses, increase at 10% per year, that Property Taxes increase 2% per year, and that Management Expenses are 5% of Gross Income.

4106. **Allowable Rent Increases**

Upon filing of an individual petition by a landlord, the Board may permit rent increases, unless otherwise proscribed by law such that the landlord's Net Operating Income will be increased at the rate of forty percent (40%) of the increase in the Consumer Price Index (CPI) over the Base Year. The increase in the CPI shall be calculated by dividing the most recently reported monthly figure at the time of filing of the petition by the monthly figure for April, 1978 (4/78 CPI=189.6).p

4107. **Limit on Annual Increases**

Notwithstanding any other provisions of this regulation, no upward rent adjustment may be authorized for any given year in an amount in excess of *twelve percent (12%)* or twice the Employment Cost Index (ECI) *whichever is greater*. The applicable figure for the ECI shall be the most recently reported calendar year figure at the time of the filing of the

petition. If the amount of any individual adjustment otherwise justified under this regulation is greater than said limit, the full justified amount shall be granted over a period of years such that the rent does not increase by greater than the said limit in any given year. *The annual rent limitation shall be inclusive of the general adjustment.*

4108. **Relationship to General Adjustment**

Any Individual Adjustment established pursuant to this Chapter shall take into account the extent of any General Adjustments the landlord may be implementing, or otherwise entitled to, at and during the time their Individual Adjustment is to be implemented, and the Individual Adjustment may be limited or conditioned accordingly. The Board shall calculate and establish General Adjustments consistent with this Subchapter.

4109. **Relationship to Other Individual Rent Adjustments**

Any landlord who has previously received an individual rent adjustment pursuant to a petition filed before October 19, 1981, where said rent adjustment has resulted in rent increases over a period of years pursuant to a schedule, may elect to have such schedule remain in effect until its termination, or may re-petition pursuant to this Subchapter upon relinquishing all rights under said schedule.

4110. **Retroactive Effect**

In no event shall retroactive rent increases be authorized by application of this Regulation, except as permitted by §1805(d)(11) of the Rent Control Charter Amendment.

4111. **Partial Invalidity**

If any provision of this Regulation or application thereof to any person or circumstances is held invalid, this invalidity shall not affect other provisions or applications of this Regulation which can be given effect without the invalid provision or application, and to this end the provisions of

this Regulation are declared to be severable. This Regulation shall be liberally construed to achieve the purposes of this Regulation and to preserve its validity.

PROOF OF SERVICE BY MAIL

State of California

ss.

County of Los Angeles

I, the undersigned, say: I am and was at all times herein mentioned, a citizen of the United States and a resident of the County of Los Angeles, over the age of eighteen (18) years and not a party to the within action or proceeding; that my business address is 11333 Iowa Avenue, Los Angeles, California 90025; that on December 18, 1986, I served the within *Jurisdictional Statement* in said action or proceeding by depositing true copies thereof, enclosed in a sealed envelope with postage thereon fully prepaid, in the United States mail at Los Angeles, California, addressed as follows:

Clerk, United States
Supreme Court
One First Street, N.W.
Washington, D.C. 20543
(Original and forty copies)

Clerk, California Supreme
Court
3580 Wilshire Boulevard
Second Floor
Los Angeles, California 90010

Clerk of the California
Superior Court
Hon. Richard A. Lavine
111 North Hill Street
Los Angeles, California 90012

Clerk of the California
Superior Court
Hon. Thomas T. Johnston
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Clerk of the California
Court of Appeal
Second Appellate District
Division Three
3580 Wilshire Boulevard
Third Floor
Los Angeles, California 90010

I declare under penalty of perjury that the foregoing is true and correct. Executed on December 18, 1986, at Los Angeles, California.

Sharon L. Stewart
(Original signed)